PAYMENT OF ATTORNEYS' FEES IN TAX LITIGATION

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS HOUSE OF REPRESENTATIVES

NINETY-SEVENTH CONGRESS

FIRST SESSION

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PAYMENT OF ATTORNEYS' FEES IN TAX LITIGATION

MONDAY, SEPTEMBER 28, 1981

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, D.C.

The subcommittee met at 10:40 a.m., pursuant to notice, in room H-137, the Capitol, Hon. Fortney H. (Pete) Stark (chairman of the subcommittee) presiding.

[Press release announcing hearing, staff background material, and bills under consideration, follow:]

[Press release of September 23, 1981]

HON. FORTNEY H. (PETE) STARK, CHAIRMAN, SUBCOMMITTEE ON SELECT REVENUE MEASURES, COMMITTEE ON WAYS AND MEANS, ANNOUNCES RESCHEDULING OF PUBLIC HEARING ON LEGISLATIVE PROPOSALS RELATING TO PAYMENT OF ATTORNEYS' FEES IN TAX LITIGATION FOR MONDAY, SEPTEMBER 28, 1981

The Honorable Fortney H. (Pete) Stark (D., Calif.), Chairman of the Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives today announced that the public hearing on legislative proposals relating to payment of attorneys' fees in tax litigation, originally scheduled for September 10, 1981, will be held on Monday, September 28, 1981, at 10:30 a.m. in Room H-137 in the U.S. Capitol.

The lead-off witnesses for the hearing are expected to be the Honorable John E. Chapoton, Assistant Secretary for Tax Policy, Department of the Treasury, and the Honorable Roscoe L. Egger, Jr., Commissioner of the Internal Revenue Service.

In an earlier Subcommittee press release, a deadline was given for making requests to appear in person at the hearing. That deadline has passed and the Subcommittee will not take any further requests to testify. However, submissions for the record received by Thursday, October 1, 1981, will be put in the official hearing record.

[JOINT COMMITTEE PRINT]

DESCRIPTION OF LAW AND BILLS

RELATING TO

AWARDS OF ATTORNEY'S FEES IN TAX CASES

(Public Law 96–481, H.R. 1095, H.R. 2555, and H.R. 3262)

SCHEDULED FOR A HEARING

BY THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ON SEPTEMBER 28, 1981

PREPARED FOR THE USE OF THE

COMMITTEE ON WAYS AND MEANS

BY THE STAFF OF THE

JOINT COMMITTEE ON TAXATION

SEPTEMBER 24, 1981

U.S. GOVERNMENT PRINTING OFFICE
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INTRODUCTION

This pamphlet describes legislative proposals relating to the payment of attorney's fees to taxpayers who prevail in tax litigation against the Government. It has been prepared by the staff of the Joint Committee on Taxation in connection with a public hearing on these proposals scheduled for September 28, 1981, by the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means.

The pamphlet includes an outline of present law provisions which allow awards for attorney's fees in tax cases in limited circumstances; a description of the provisions enacted in Public Law 96–481, in the 96th Congress, which provide for such awards in certain tax cases in the Federal district courts and the United States Court of Claims, and which will become effective October 1, 1981; as well as an explanation of three bills which amend Public Law 96–481: H.R. 1095 (introduced by Mr. Hinson), H.R. 2555 (introduced by Mr. Rousselot), and H.R. 3262 (introduced by Messrs. Stark, Mazzoli, Morrison, Bafalis, and others).

I. BACKGROUND

A. Present Law

Provisions in Effect

The Civil Rights Attorney's Fees Awards Act of 1976 (42 U.S.C. sec. 1988) provides, in part, that in any civil action or proceeding, brought by or on behalf of the United States, to enforce, or charging a violation of, a provision of the Internal Revenue Code, the court, in its discretion, may allow the prevailing party, other than the United States, reasonable attorney's fees as part of the costs. This provision has limited applicability to tax litigation and results in very few fee awards, because it is limited to actions brought by or on behalf of the Government (that is, to cases in which the taxpayer is the defendant). Most civil tax litigation is initiated by the taxpayer who brings suit against the Government. In the United States Tax Court, the taxpayer is the petitioner in a deficiency proceeding. In the Federal district courts and the U.S. Court of Claims, the taxpayer is the plaintiff suing the Government for a refund.

Provisions Effective October 1, 1981

Last year, as part of Public Law 96–481, the Congress enacted the Equal Access to Justice Act (28 U.S.C. sec. 2412) which, in part, authorizes awards to a prevailing party other than the United States of fees and other expenses incurred by that party in any civil action (other than cases sounding in tort) brought by or against the United States in any court having jurisdiction of that action, unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust. This provision applies to tax cases in the Federal district courts and the United States Court of Claims. However, it does not apply to cases in the United States Tax Court. Because the provision applies to cases in which taxpayers are plaintiffs and not merely to cases brought by the Government, it creates a greater potential for such awards in tax cases. This provision will take effect on October 1, 1981 and will apply through final disposition of any action commenced before October 1, 1984.

Under the Equal Access to Justice Act, fees and other expenses that may be awarded to a prevailing party include the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable attorney's fees. In general, no expert witness may be compensated at a rate that exceeds the highest rate of compensation for expert witnesses paid by the United States. Attorneys' fees in excess of $75 per hour may not be awarded unless the court determines that a higher fee is justified. In general, parties who may recover fees and expenses under the Act are:

(1) individuals whose net worth does not exceed $1,000,000 at the time the action is filed; (2) sole owners of an unincorporated business, partnership, corporation, association, or organization whose net worth does not exceed $5,000,000 at the time the civil action is filed (however, tax-exempt charitable organizations and certain cooperative associations are not subject to this net worth limitation); and (3) sole owners of an unincorporated business, partnership, corporation, association, or organization that has no more than 500 employees at the time the action is filed.

B. Issues

In General

Fee awards in tax cases.—The principal issue is whether taxpayers who prevail in civil tax actions should be entitled to awards for attorney's fees. Proponents of fee awards in tax cases contend that these awards are necessary to deter abusive actions or overreaching by the Internal Revenue Service and to enable the individual taxpayer to vindicate his rights regardless of his economic circumstances. Opponents claim that fee awards in tax actions could seriously impair the administration of the tax laws. It is argued that the availability of fee awards would encourage taxpayers to litigate disputes rather than pursue administrative remedies, thereby increasing the already heavy volume of tax cases in the courts. An increase in tax litigation would generally impair the taxpayer's ability to obtain prompt resolution of a dispute. It is further argued that fee awards in tax cases are inappropriate because the taxpayer is generally not enforcing any rights beyond his own vested interest.

Specific Issues

If such awards are allowed, a number of related issues arise.

Courts having jurisdiction.—One issue is whether the provision for awards should apply in all courts having jurisdiction over tax issues. The Equal Access to Justice Act applies only to Federal district courts and the U.S. Court of Claims. Critics contend that the availability of fee awards in only these courts encourages forum shopping and makes an award depend upon the fact of whether the taxpayer paid the amount of tax at issue before suing the Government. Moreover, the majority of tax litigation occurs in the United States Tax Court. Thus, excluding the Tax Court from application of the provision would greatly restrict the payment of attorney's fees in tax litigation generally.

Availability in administrative proceedings.—A further consideration is whether fee awards should be available in administrative proceedings. Proponents contend that unless fee awards are available at the administrative phase of a dispute between the Service and the taxpayer, taxpayers will be encouraged to bypass their administrative remedies and pursue litigation in order to obtain attorney's fees. Critics of the availability of fee awards in administrative proceedings argue that they would add expense and complexity to the system of administrative appeals within the Internal Revenue Service which has been effective in resolving approximately 95 percent of disputes between the taxpayer and the Government without trial.

Types of tax controversies.—A related issue is the types of tax controversies or proceedings for which fee awards should be available.

It has been argued that awards should not be available in State court proceedings such as probate cases, State receiverships, assignments for the benefit of creditors or, interpleaders where the action of the government is not discretionary. Also, it is further argued that certain declaratory judgment actions such as classification of organizations as tax-exempt, the qualification of certain retirement plans, and status of certain governmental obligations should be exempt from fee awards since, in these cases, the taxpayer is not seeking to vindicate his rights, but rather is hoping to qualify for a kind of favorable tax treatment not generally available to taxpayers without special characteristics. Others contend that the provision for fee awards can only be equitable and effective if it applies in all cases where the taxpayer opposes the Government, since the nature of the controversy, generally, does not affect the ability of the taxpayer to litigate against the Government.

Standards for award.—A significant issue in the award of attorney's fees is the standards for determining if an award should be made. Some have argued that the court should have discretion to determine when an award is appropriate. Opponents of this standard argue that it still keeps the taxpayer at the mercy of the Government.

Others have argued that the prevailing party should be automatically entitled to an award of fees. Opponents of this standard contend that it is often difficult to determine who the prevailing party is in tax litigation, since a number of unrelated factual issues and taxable years may be involved in a case. Moreover, the Government should not necessarily be penalized for the reasonable pursuit of debatable tax issues. Tax administration would be ineffective if the Government conceded all close cases to the taxpayer in order to avoid payment of fee awards.

A third standard has also been advocated under which the prevailing party must show that the action of the Government in pursuing litigation was unreasonable. Proponents of this standard contend that this would protect the taxpayer from Government abuses and encourage responsible Government action while, at the same time, avoid the potential for a massive increase in the burden of the courts. Opponents of this standard claim that taxpayers would rarely recover because the evidence of unreasonable conduct is usually in the possession of the Government. Moreover, the taxpayer already has the burden of proving either that he is entitled to a refund or not liable for a certain amount of taxes in order to prevail in the case.

Eligible recipients.—There is a further issue of what taxpayers should be eligible for fee awards. The Equal Access to Justice Act places income and size limitations on recipients. Proponents of these types of limitations argue that fee awards are intended to enable those taxpayers who would not otherwise be able to afford to defend their interests to litigate. It is contended that more affluent taxpayers who were awarded fees would be receiving a windfall. Opponents of these limitations contend that the taxpayer's wealth or company size should not affect the determination of whether an award is appropriate. Some advocates have proposed that the Government also be eligible for fee awards. It is argued that this would deter frivolous taxpayer suits. Opponents contend, however, that permitting the Government to recover fees would chill all taxpayer suits including meritorious ones.

Nature and extent of costs.—The nature and extent of costs to be recovered also should be considered. Costs of litigation may include not only attorney's fees and court costs but also accountants' fees, expenses of expert witnesses, or the costs of studies, lab tests, engineering reports necessary for the preparation of a case, travel, clerical assistance, preparation of documents, and other related expenses. Some have argued that all of these costs should be explicitly included in any fee award provision. Others have argued that an award of these expenses may not be appropriate or reasonable in every case. They urge that the court have discretion to determine reasonable attorney's fees and costs.

It has also been argued that the overall amount of recovery should be limited. Proponents of a dollar limit claim that the most complex and sophisticated tax issues and, thus, the most costly are generally raised by more affluent individuals and corporations. In addition, a dollar limit might encourage early settlements in docketed cases. Therefore, in order to discourage excessive litigation and yet assure relief to taxpayers with limited resources, it is argued that a ceiling on the amount of the award is appropriate. Critics of a ceiling argue that the wealth of the taxpayer should not affect the determination of whether a taxpayer should be reimbursed for the costs of litigation. They urge that the determination be based on an evaluation of the facts of each case, rather than the characteristics of the taxpayer.

Temporary or permanent provision.—A final issue to be considered is whether a provision authorizing the award of attorney's fees in tax cases should be permanent. Since fee awards do constitute a departure from the usual procedure in the American judicial system where, generally, litigants bear their own costs, some have urged that attorney's fee legislation expire after a number of years. Proponents of a sunset provision argue that it would afford administrators, legislators, and practitioners an opportunity to assess the effects of the legislation. The Equal Access of Justice Act, itself, has a sunset date of October 1, 1984. Opponents of a sunset provision argue that permanent fee award legislation is necessary to deter abusive Government action and enable taxpayers to defend their interests. Moreover, critics contend that it could create difficult transitional problems for cases pending on the sunset date.

II. DESCRIPTION OF BILLS

A. H.R. 3262 (Mr. Stark, et al.): Taxpayer Protection and Reimbursement Act

In general

The bill would provide for the award of reasonable court costs to prevailing parties in civil tax actions. Specifically, court costs could be awarded in civil actions or proceedings brought by or against the United States in any United States court, including the Tax Court, for the determination, collection, or refund of any tax, interest, or penalty. Thus, parties who are plaintiffs or defendants in suits involving the determination, collection, or refund of any tax, interest, or penalty imposed by the Internal Revenue Code would be eligible for these awards. However, no award could be made to the United States or to a creditor of the taxpayer.

Limitations

The amount of reasonable court costs to be awarded to any prevailing party in any civil action or proceeding would be limited to a maximum of $20,000. Moreover, awards would be allowed only to the extent the costs are allocable to the United States and not to any other party to the action or proceeding.

Reasonable court costs

Under the bill, reasonable court costs would include (1) the reasonable expenses of expert witnesses, (2) the reasonable cost of any study, analysis, engineering report, test, or project that is found by the court to be necessary for the preparation of the party's case, and (3) reasonable fees paid or incurred for the services of attorneys. In the case of Tax Court proceedings, fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court would be treated as fees for the services of an attorney.

Prevailing party

The bill provides guidelines for determining who is a prevailing party, for purposes of awarding court costs. A prevailing party would be a party (other than the United States or a creditor of the taxpayer involved) who (1) establishes that the position of the United States in the civil action or proceeding was unreasonable, and (2) has substantially prevailed with respect to the amount in controversy or has substantially prevailed with respect to the most significant issue, or set of issues, presented.

The determination of who is a prevailing party would be made either by the court or by agreement of the parties.

Excluded actions

The bill would exclude certain civil actions and proceedings from those eligible for awards. The excluded actions would be:

(1) Declaratory judgments with respect to the status and classification of organizations as tax-exempt organizations, qualified charitable donees, private foundations, or private operating foundations (unless the action or proceeding involves the revocation of the tax-exempt status of a charitable organization);

(2) Declaratory judgments with respect to the initial or continuing qualification of certain retirement plans;

(3) Declaratory judgments with respect to whether a transfer of property from a United States person to a foreign corporation has the avoidance of Federal income taxes as one of its principal purposes; and

(4) Declaratory judgments with respect to the status of certain governmental obligations for purposes of the income tax exclusion for interest under Code section 103(a).

The bill would make its new Code provision for awards of court costs the exclusive provision for such awards in any tax cases to which this new provision applies. Thus, taxpayers would have to seek such awards for costs in tax litigation under new Code section 7430 and would be denied awards under the Equal Access to Justice Act.

Multiple actions

The bill would require that multiple actions which could have been joined or consolidated, and a case or cases involving a return or returns of the same taxpayer (including a married couple's joint returns) which could have been joined in a single proceeding in the same court, generally must be treated as a single action or proceeding, whether or not joined or consolidated for purposes of awarding court costs. However, if the court determines that it would be inappropriate to treat such cases as joined or consolidated, for purposes of awarding court costs, awards may be determined for the cases separately.

Right of appeal

An order granting or denying an award would be incorporated as part of the court's decision or judgment. The order would be appealable in the same manner, and to the same extent, as the decision or judgment.

Source of awards

Payments of awards would be made from the funds of the government agency involved in the action or proceeding.

Effective date

The provisions of the bill would apply to civil actions and proceedings filed after December 31, 1980, and before January 1, 1991.

B. H.R. 2555 (Mr. Rousselot)

In general

The bill would authorize the payment of attorney's fees and costs to the prevailing party in any civil action involving tax liability that is brought by or against the United States (or any agency or official), provided that a party other than the United States (or any agency or official) prevails.

Standards for award

The bill does not specify the standard for an award. Thus, an award of attorney's fees is not required in any action. The award of reasonable attorney's fees and costs would be within the discretion of the court having jurisdiction of the action, provided the recipient is a prevailing party other than the United States.

Effective date

The bill would be effective upon enactment.

C. H.R. 1095 (Mr. Hinson): Legal Fees Reimbursement Act of 1981

In general

This bill would require the Government to reimburse a taxpayer for all reasonable litigation expenses incurred in certain litigation if the taxpayer prevails, or substantially prevails, against the Government. Reimbursement would be authorized in (1) any litigation, proceeding, or court action arising from legal action originally instituted by the Government (even if later withdrawn by the Government) or (2) in any action instituted by a taxpayer to contest the accuracy of a deficiency assessment or to claim a refund of taxes paid.

Reasonable litigation expenses, for which the bill would authorize reimbursement, would include all actual attorney's fees, court costs, expert witnesses, clerical assistance, travel expenses, preparation of documents, and other related and necessary expenses.

Effective date

The bill would be effective upon enactment.

97TH CONGRESS
1ST SESSION

H. R. 1095

To amend the Internal Revenue Code of 1954 to provide for payment by the Government of all reasonable litigation expenses to prevailing taxpayers in legal actions.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 22, 1981

Mr. HINSON introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 to provide for payment by the Government of all reasonable litigation expenses to prevailing taxpayers in legal actions.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Legal Fees Reimbursement Act of 1981".

SEC. 2. (a) Subchapter B of chapter 76 of the Internal Revenue Code of 1954 is amended by redesignating section 7430 as section 7431 and by inserting after section 7429 the following new section:

"SEC. 7430. REIMBURSEMENT OF LEGAL FEES.

"(a) GENERAL RULE.—In any litigation, proceeding, or court action arising from legal action originally initiated by the Government under this title, even though later withdrawn by the Government, or in any action instituted by a taxpayer contesting the accuracy of a deficiency assessment or claiming a refund of taxes paid, the taxpayer having prevailed, or substantially prevailed (Government withdrawal being construed as the Government having not prevailed), the Government shall be liable for the reimbursement in full of all reasonable litigation expenses incurred by the taxpayer as a consequence of legal defense, and the court shall order such reimbursement in full.

"(b) REASONABLE LITIGATION EXPENSES.—For purposes of subsection (a), reasonable litigation expenses shall include all actual attorneys' fees, court costs, expert witnesses, clerical assistance, travel expenses, preparation of documents, and other related and necessary expenses."

(b) The table of sections for such subchapter B is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 7430. Reimbursement of legal fees.
"Sec. 7431. Cross references."

97TH CONGRESS
1ST SESSION

H. R. 2555

To amend the Internal Revenue Code of 1954 to authorize the payment of attorney's fees to taxpayers who prevail in tax litigation.

IN THE HOUSE OF REPRESENTATIVES

MARCH 17, 1981

Mr. ROUSSELOT introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To amend the Internal Revenue Code of 1954 to authorize the payment of attorney's fees to taxpayers who prevail in tax litigation.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subchapter B of chapter 76 of the Internal Revenue Code of 1954 (relating to proceedings by taxpayers and third parties) is amended by redesignating section 7430 as section 7431 and by inserting after section 7429 the following new section:

"SEC. 7430. JUDGMENT FOR ATTORNEY'S FEES.

"In the case of any civil action—

"(1) which is brought by or against the United States or any agency or official of the United States acting in his official capacity and which involves the liability of any person for any tax imposed by this title, and

"(2) in which a party other than the United States (or such agency or official) prevails,

the court having jurisdiction of such action may, in its discretion, award to such prevailing party a judgment for reasonable attorney's fees and costs.".

(b) The table of sections for subchapter B of chapter 76 of such Code is amended by striking out the last item and inserting in lieu thereof the following:

"Sec. 7430. Judgment for attorney's fees.
"Sec. 7431. Cross references.".

97TH CONGRESS
1ST SESSION

H. R. 3262

To amend the Internal Revenue Code of 1954 to provide for the awarding of reasonable court costs and certain fees to prevailing parties in civil tax actions, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 27, 1981

Mr. STARK introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954 to provide for the awarding of reasonable court costs and certain fees to prevailing parties in civil tax actions, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Taxpayer Protection and Reimbursement Act".

SEC. 2. AWARDING OF COSTS AND CERTAIN FEES.

(a) IN GENERAL.—Subchapter B of chapter 76 of the Internal Revenue Code of 1954 (relating to proceedings by

taxpayers and third parties) is amended by redesignating section 7430 as section 7431 and by inserting after section 7429 the following new section:

"SEC. 7430. AWARDING OF COURT COSTS AND CERTAIN FEES.

"(a) IN GENERAL.—In the case of any civil action or proceeding which is—

"(1) brought by or against the United States for the determination, collection, or refund of any tax, interest, or penalty under this title, and

"(2) brought in a court of the United States (including the Tax Court),

the prevailing party may be awarded a judgment for reasonable court costs incurred in such action or proceeding.

"(b) LIMITATIONS.—

"(1) MAXIMUM DOLLAR AMOUNT.—The amount of reasonable court costs which may be awarded under subsection (a) with respect to any prevailing party in any civil action or proceeding shall not exceed $20,000.

"(2) ONLY COSTS ALLOCABLE TO THE UNITED STATES.—An award under subsection (a) shall be made only for reasonable court costs which are allocable to the United States and not to any other party to the action or proceeding.

"(c) DEFINITIONS.—For purposes of this section—

"(1) REASONABLE COURT COSTS.—

"(A) IN GENERAL.—The term 'reasonable court costs' includes the reasonable expenses of expert witnesses, the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and reasonable fees paid or incurred for the services of attorneys.

"(B) ATTORNEY'S FEES.—In the case of any proceeding in the Tax Court, fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court shall be treated as fees for the services of an attorney.

"(2) PREVAILING PARTY.—

"(A) IN GENERAL.—The term 'prevailing party' means any party to any action or proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which—

"(i) establishes that the position of the United States in the civil action or proceeding was unreasonable, and

"(ii)(I) has substantially prevailed with respect to the amount in controversy, or

"(II) has substantially prevailed with respect to the most significant issue or set of issues presented.

"(B) DETERMINATION AS TO PREVAILING PARTY.—Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made—

"(i) by the court, or

"(ii) by agreement of the parties.

"(d) EXCLUSION OF CERTAIN CIVIL ACTIONS OR PROCEEDINGS.—No award for reasonable court costs may be made under subsection (a) with respect to any civil action or proceeding brought under—

"(1) section 7428 (relating to declaratory judgments with respect to status and classification of organizations under section 501(c)(3), etc.), unless such action or proceeding involves the revocation of the tax-exempt status of an organization described in section 501(c)(3),

"(2) section 7476 (relating to declaratory judgments with respect to qualification of certain retirement plans),

"(3) section 7477 (relating to declaratory judgments with respect to transfers of property from the United States), or

"(4) section 7478 (relating to declaratory judgments with respect to status of certain governmental obligations).

"(e) MULTIPLE ACTIONS.—For purposes of this section, in the case of—

"(1) multiple actions which could have been joined or consolidated, or

"(2) a case or cases involving a return or returns of the same taxpayer (including joint returns of married individuals) which could have been joined in a single proceeding in the same court,

such actions or cases shall be treated as one civil action or proceeding regardless of whether such joinder or consolidation actually occurs, unless the court in which such action or proceeding is brought determines, in its discretion, that it would be inappropriate to treat such actions or cases as joined or consolidated for purposes of this section.

"(f) RIGHT OF APPEAL.—An order granting or denying an award for reasonable court costs under subsection (a), in whole or in part, shall be incorporated as a part of the decision or judgment in the case and shall be subject to appeal in

the same manner and to the same extent as the decision or judgment.

"(g) SOURCE OF PAYMENT.—Payment of any award for reasonable court costs under subsection (a) shall be made by the agency over which the party prevails from any funds made available to the agency, by appropriation or otherwise, for such purpose.".

(b) APPLICATION WITH TITLE 28.—Section 2412 of title 28, United States Code, is amended by adding at the end thereof the following new subsection:

"(e) The provisions of this section shall not apply to any costs, fees, and other expenses in connection with any action or proceeding to which section 7430 of the Internal Revenue Code of 1954 applies.".

(c) CONFORMING AMENDMENTS.—

(1) The table of sections for subchapter B of chapter 76 of such Code is amended by striking out the item relating to section 7430 and inserting the following new items:

"Sec. 7430. Awarding of court costs and certain fees.
"Sec. 7431. Cross references.".

(2) Section 722 of the Revised Statutes (42 U.S.C. 1988) is amended by striking out immediately after "Public Law 92–318" the clause "or in any civil action or proceeding, by or on behalf of the United

States of America, to enforce, or charging a violation of, the United States Internal Revenue Code,".

SEC. 3. EFFECTIVE DATE.

The amendments made by this title shall apply to civil actions or proceedings filed after December 31, 1980, and before January 1, 1991.

Chairman STARK. The subcommittee will proceed.

As you know, this morning the Subcommittee on Select Revenue Measures is considering an issue which will have a significant impact upon taxpayers—perhaps more on nontaxpayers—and the way in which our tax laws are administered—Government payment of the taxpayer's attorneys' fees when the individual prevails in litigation against the Government.

Beginning this Thursday, as a result of the enactment of the Equal Access to Justice Act last year, taxpayers will be able to collect attorneys' fees in the U.S. district courts and U.S. Court of Claims if they prevail in cases brought against the Government.

Unfortunately, the Ways and Means Committee did not have the opportunity to review this legislation before enactment, since it was a Senate floor amendment to an unrelated small business bill. Therefore, the new law fails to take account of some of the unique characteristics of tax cases.

In addition, and perhaps more importantly, it does not apply to Tax Court cases, which represent nearly 90 percent of all tax litigation. This severely restricts the availability of fee awards to taxpayers, especially those who cannot pay the tax in order to litigate in the U.S. district courts or U.S. Court of Claims.

Several of my colleagues and I have been concerned about this issue and have introduced legislation which attempts to provide relief for the taxpayer and still address the unique characteristics of tax cases. I, for one, am extremely interested in hearing the views of the Treasury Department and the Internal Revenue Service on Public Law 96–481, our bill, H.R. 3262, and the other proposals before us, since the Treasury and the Service are faced with implementing the fee award requirements.

Therefore, I am pleased to welcome to the subcommittee John E. Chapoton, Assistant Secretary for Tax Policy, and Roscoe L. Egger, Jr., Commissioner of the Internal Revenue Service.

I want to add that it has come to my attention that five or six States are now considering or experimenting with laws of this type, which would award attorneys' fees and costs to people who prevail when they are sued. I think there is some tendency in this country to do this in some cases as a punishment to those people who capriciously bring lawsuits as a harassing or stalling measure, and also genuinely to correct a wrong when an innocent person is faced with horrendously high legal costs, after having been the subject of one of these either capricious or harassing lawsuits. There seems to be a movement in the country in that direction. As a layman, I am sometimes confused by the legal terms, but I think I understand what we are trying to do for the American people. So I would ask either of you gentlemen in whichever order you choose to proceed, and without objection your written statements will be made part of the record.

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Thank you, Mr. Chairman. Mr. Egger and I have a joint written statement. It is somewhat lengthy, and we will each present a rather short oral statement if we might.

We are pleased to have the opportunity to present the views of the Treasury and the IRS on this very significant question, at times being pushed upon us as you state, because this Thursday we already have a law that will go into effect relating to cases in the Court of Claims and the district court.

In general, Mr. Chairman, we oppose extension of provisions authorizing broad-based attorneys' fees awards to the U.S. Tax Court. We believe that the disadvantages associated with any provision for attorneys' fees in tax cases far outweigh any potential benefits. On the other hand, we cannot condone, and the system should not tolerate, bad faith Government conduct. While we have some reservations concerning its practical impact on the settlement process and the Tax Court backlog, we would not oppose a statute imposing liability for fees and costs in cases where the Government is shown to have acted in bad faith. If such a proposal were adopted, we would urge that it be made clear that the standard for recovery should be construed strictly by the courts, and that clean hands be a prerequisite to recovery.

We also believe that the measure should not apply to pending cases, that it should include a sunset provision, and that it should exclude certain types of ancillary proceedings. We would also recommend that the provision of the Internal Revenue Code which already authorizes the Tax Court to impose an award of damages of up to $500 when a proceeding has been instituted merely for delay be broadened to include bad faith conduct by private parties, and that the maximum amount of damages which may be assessed by the court be increased significantly.

Although we believe that any broad-based attorneys' fees measure would be ill-advised and counterproductive in the context of tax litigation, if such a measure is to be enacted we feel that moderating features similar to those included in your bill, Mr. Chairman, H.R. 3262, are necessary.

We remain convinced, however, that any such measure will confer only marginal benefits from the standpoint of facilitating private party access to the judicial process, and could well have a material adverse impact on settlement procedures, the timely judicial resolution of tax cases and the vigorous and evenhanded enforcement of the tax laws by the Service and by a Tax Court already under severe stress from its docket.

I would like now to turn to Mr. Egger. Commissioner Egger will discuss some of the administrative implications of the legislative approaches which are being considered by the subcommittee.

Chairman STARK. I would like, if I may intrude here, to make known the presence of Congressman Schulze of Pennsylvania, who has joined us. He may have an opening statement, but I think we will reserve that.

Mr. SCHULZE. I have no opening statement.

Chairman STARK. Mr. Egger?

STATEMENT OF HON. ROSCOE L. EGGER, JR., COMMISSIONER, OF INTERNAL REVENUE, DEPARTMENT OF THE TREASURY

Mr. EGGER. Mr. Chairman, the bills being considered by the committee would provide for an award of fees either whenever the Government loses or whenever the other party "substantially pre-

vails" and the Government's position is found to be "unreasonable." Under either standard, it appears that a substantial number of fee awards is contemplated.

We are genuinely concerned about the budgetary implications of requiring the entire taxpaying public to shoulder the expenses of those taxpayers who choose to litigate their disputes.

We are, however, primarily concerned about the potential effect of such legislation on the Tax Court. We have included with our written statement data on the Tax Court docket. This data makes clear that the volume of Tax Court litigation is expanding at phenomenal rates. The problem today is not one of judicial access but of timely resolution.

Last June the Tax Court docket reached 40,000 pending cases. We estimate that by the end of the year the Tax Court docket will approach 50,000 cases, a doubling of the court's caseload in just 5 years. The adverse impact of the Tax Court's present docket is being felt by the Service and by those individual taxpayers entitled to prompt resolution of their legitimate disputes.

We must also be mindful of the fact that unpaid deficiencies in excess of $5 billion are the subject of pending Tax Court litigation, and that many additional billions of dollars are the subject of prelitigation controversies. Further delays in resolving these matters will only increase the burden on the entire taxpaying public.

In our judgment, each of the attorneys' fees proposals being considered by the committee would significantly encourage more taxpayers to take their cases to the Tax Court at a time when the court is already experiencing difficulty in disposing of those cases now pending before it.

Also, the current backlog problem would only be compounded by additional demands on the court's time for purposes of resolving the attorneys' fee claims.

None of these proposals incorporates a requirement that the taxpayer exhaust the administrative appeals process prior to docketing a tax case in the Tax Court. By encouraging taxpayers to bypass the administrative appeals procedure of the Service, these measures undermine one of the principal forums for the orderly resolution of disputes and for reducing the Tax Court's flow of new cases.

The proposals' failure to require good faith and timely disclosure by a taxpayer of the facts of the taxpayer's case represents another serious flaw. The measures under consideration could also have an adverse impact on so-called small case procedures. These procedures were adopted by Congress to provide for an informal and expeditious method of resolving cases involving relatively limited amounts in controversy. The proposed attorneys' fees measures under consideration would create incentives not to use the small case procedure at all or to introduce more costly and time consuming formalities. Perhaps the most serious defect in all the proposals is, however, the failure to address precisely what cases are appropriate for fee awards.

We are very troubled by suggestions that fee awards may be appropriate on a "strict liability" basis or when the Service seeks to establish the meaning of the tax law through litigation. We are also very concerned that a vague standard such as "reasonable-

ness," when adopted in the tax context, may have a chilling effect on the enforcement of the internal revenue laws.

In excluding Tax Court cases from its coverage, the Equal Access to Justice Act properly recognizes the unique nature of tax cases and the fact that different treatment for fees and costs might well be appropriate. Ideally we would prefer that Equal Access to Justice Act coverage of tax cases in the district courts and Court of Claims be eliminated.

However, because the Equal Access to Justice Act is already in place, and is to some extent experimental, and because the vast preponderance of tax litigation is before the Tax Court, we do not feel compelled to advocate modification of the Equal Access to Justice Act at this time.

On the other hand, if a bad faith standard is enacted for the Tax Court, we would urge that it be adopted as the exclusive basis for an award of attorneys' fees in tax litigation, not only in the Tax Court but in the district court and Court of Claims as well.

We appreciate the opportunity to appear before you this morning, and we will be happy to respond to any questions you may have at this time.

[The prepared joint statement of Mr. Chapoton and Mr. Egger follows:]

JOINT STATEMENT OF JOHN E. CHAPOTON, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY, AND ROSCOE L. EGGER, JR., COMMISSIONER OF INTERNAL REVENUE

Mr. Chairman and members of the Subcommittee, we are pleased to present today the views of the Department of the Treasury and the Internal Revenue Service on legislative proposals for payment of attorneys' fees in tax litigation.

In general, we oppose extension of provisions authorizing broad-based attorneys' fees awards to the United States Tax Court. We would not oppose, however, a limited measure authorizing a discretionary award of fees in tax cases generally when the petitioner demonstrates that the Governmnt has acted in bad faith. A provision such as this would allow for compensation in those cases in which the Government is guilty of overreaching, without encouraging a flood of new Tax Court litigation. By the same token, we would also recommend that provisions of section 6673 of the Internal Revenue Code, which already authorizes the Tax Court to impose an award of damages of up to $500 when a proceeding has been instituted merely for delay, be broadened to include bad faith conduct by private parties, and that the maximum amount of damages which may be assessed by the Court be increased significantly.

BACKGROUND

Attachment 1 contains some of the data which provides a backdrop for our position on attorneys' fees. It makes clear that the volume of Tax Court litigation is expanding at phenomenal rates. The problem today is not one of judicial access but of timely resolution.

IMPACT OF BROAD-BASED ATTORNEYS' FEES MEASURES

The bills being considered by the Committee would provide for an award of fees either whenever the Government loses (H.R. 1095 and 2555) or whenever the other party "substantially prevails" and the Government's position was "unreasonable" (H.R. 3262). Under either standard, it appears that a substantial number of fee awards is contemplated. We are genuinely concerned about the budgetary implications of requiring all taxpayers to shoulder the expenses of those taxpayers who choose to litigate.

We are, however, primarily concerned about the potential effect of such legislation on the Tax Court. Last June, the Tax Court docket reached 40,000 pending cases. By the end of the year, we estimate that it will approach 50,000 cases—a doubling of the Court's caseload in just five years. Efforts are underway within the Internal Revenue Service and the Office of the Chief Counsel to expedite pending matters.

The Tax Court has also increased substantially its output and continues to explore new ways to expedite the handling of cases. Nonetheless, new filings this year will exceed dispositions by almost 8,000 cases. In short, major efforts will be required simply to manage the Court's existing caseload. Any new policy which encourages Tax Court litigation can only exacerbate an already serious problem.

Justice delayed is indeed justice denied, and the adverse impact of the Tax Court's present docket is being felt by the Service and by the individual taxpayers entitled to prompt resolution of their legitimate disputes. We must also be mindful of the fact that unpaid deficiencies in excess of 5 billion dollars are the subject of Tax Court litigation, and that many additional billions of tax dollars are the subject of pre-litigation controversies. Further delays in resolving these matters will only increase burdens on the entire taxpaying public.

In our judgment, each of the attorneys' fees proposals being considered by the Committee would significantly encourage more taxpayers to take their cases to Tax Court at a time when the Court is already experiencing difficulty in disposing of those cases now pending before it.

None of these proposals incorporates a requirement that the taxpayer exhaust the administrative appeals process prior to docketing a case in Court. This could encourage taxpayers to bypass this level of administrative review and docket their cases directly in the Tax court. By encouraging taxpayers to bypass the administrative appeals procedure of the Service, these measures undermine one of the principal forums for the orderly resolution of disputes and for reducing the Tax Court's flow of new cases. Consequently, we view the failure of such proposals to require that the taxpayer exhaust all administrative appeals before litigating as a serious defect.

The Tax Court has traditionally relied on the stipulation process rather than formal discovery to save time and expenses. The proposed attorneys' fees measures would only create incentives to "churn" cases through use of more formal procedures. Moreover, while we believe such conduct would preclude recovery, parties may be tempted to try to cause the Service to take unreasonable positions through nondislosure until the eleventh hour, creating a barrier to the free exchange of information which is the bedrock of the stipulation process. Accordingly, the proposals' failure to require good faith and timely disclosure by a taxpayer of the facts of the taxpayer's case represents another serious flaw.

The measures under consideration could also have an adverse impact on so-called "small case" procedures under Code Section 7463. These procedures were adopted by Congress to provide for an informal and expeditious method of resolving cases involving relatively limited amounts in controversy (since 1979, $5,000 or less). Not only has this approach served the interests of numerous taxpayers—but the use of special trail judges to hear these matters has freed up invaluable Tax Court time to deal with its expanding backlog of cases. The proposed attorneys' fees measures under consideration would create incentives not to use the small case procedure at all, or to introduce more costly and time-consuming formalities.

Finally, all else aside, the current backlog problem would only be compounded by additional demands on the Court's time for purposes of resolving attorneys' fees claims—not to mention increased IRS costs in processing such claims.

Perhaps the most serious defect in all the proposals, however, is the failure to address precisely what cases are appropriate for fee awards. As noted below, we would not oppose a provision giving relief in cases of "bad faith" conduct by the Government. We think such conduct occurs infrequently; when it does, compensation may well be appropriate. However, we are very troubled by suggestions that fee awards may be appropriate on a "strict liability" basis or when the Service seeks to establish the meaning of the tax law through litigation.

The function of the Internal Revenue Service is to administer the Internal Revenue Code, after tax policy is determined by Congress. The meaning of a given Code provision may be subject to varying interpretations. Revenue Service employees are charged with the responsibility of applying and administering the law in a fair, impartial, practical, yet vigorous, manner. We are very concerned that a vague standard such as "reasonableness", when adopted in a tax context, may have a chilling effect on the enforcement of the internal revenue laws.

ATTORNEYS' FEES IN CASES OF BAD FAITH GOVERNMENT ACTION

We believe that disadvantages associated with any provision for attorney's fees in tax cases far outweigh any potential benefits. On the other hand, we cannot condone, and the system should not tolerate, bad faith Government conduct. While we have some reservations concerning its practical impact of the settlement process and the Tax Court backlog, we would not oppose a statute imposing liability for fees and costs in cases where the Government is shown to have acted in bad faith. This standard has the virtue of proscribing egregious conduct by the Government, is

reasonably well-defined by existing case law, and minimizes settlement disincentives. If this proposal were adopted, we would urge that it be made clear that the standard for recovery should be construed strictly by the Courts and that "clean hands" are a prerequisite to recovery. Thus, for example, taxpayers who withhold information until the eleventh hour, fail to avail themselves of administrative remedies, delay proceedings, and the like should not be entitled to fees and costs. We also believe that the measure should not apply to pending cases, should include a "sunset" provision, and should exclude certain types of ancillary proceedings.

MODIFIED TAXPAYER PENALTY PROVISIONS

In our view, the isolated instances of bad faith Government conduct in tax cases pale before systematic abuses by certain taxpayers and taxpayer groups. Attachment 1 sets forth the number of abusive tax shelters and tax protester cases. These numbers do not begin to count the toll in terms of IRS and judicial resources. Nor do they reflect other instances where taxpayers benefit from the use of Government funds through overt and covert delay.

Virtually all tax shelter litigation takes place in the Tax Court. The ease with which Tax Court cases can be filed, the fact that the amount of the disputed tax is not due until the litigation is completed, and the delay in bringing cases up for trial, have led some investors in tax shelter schemes to realize that Tax Court litigation is itself a form of shelter. As the increasing number of tax shelters and other cases move through the administrative pipeline, we expect the Court's total number of cases to continue to increase dramatically.

If we cannot condone bad faith Government conduct, then in equal meaure we cannot condone similar conduct when engaged in by taxpayers. Code Section 6673 presently authorizes the Tax Court to award damages of up to $500 against taxpayers who institute Court proceedings merely for delay. This provision has been construed very narrowly by the Court and does not reach conduct amounting to bad faith by the taxpayer. We urge that Section 6673 be amended to allow the Tax Court, at its descretion, to award damages in those situations in which the taxpayer is found to have acted in bad faith. We also urge that the maximum amount of an award under this provision be increased significantly.

COMMENTS ON H.R. 3262

As indicated, we believe that any broad-based attorneys' fees measure would be ill-advised and counter-productive in the context of tax litigation. However, we recognize that efforts have been made to minimize a number of the problems we have described—most notably, in H.R. 3262.[1] If a broad-based attorneys' fees meaure is to be enacted, we feel that moderating features similar to those included in H.R. 3262 are necessary. For example, such legislation:

Should require that the taxpayer prove the Government's position unreasonable and substantially prevail as to amount or most significant issue(s) in controversy.

Should exclude from its coverage cases involving creditors of the taxpayer, declaratory judgments, summons proceedings, and State Court cases.

Should incorporate a reasonable monetary limit on the amount of award.

Should permit multiple actions which could have been joined as a single proceeding to be treated as a single action for fee award purposes.

Should exclude pending cases and incorporate a "sunset" provision.

However, we would supplement these provisions with the following:

A requirement that the taxpayer exhaust administrative remedies.

Denial of recovery if the taxpayer fails to make timely and good faith disclosure of the taxpayer's case.

Clarify that attempts by the Service to modify administrative positions which it determines to have been in error, and to litigate in instances where adverse decisions exist, are not per se unreasonable and are not per se grounds for recovery.

Having said as much, however, we remain convinced that any such measure, regardless of how finely drafted, will confer only marginal benefit from the standpoint of facilitating private party access to the judicial process—and could well have a material adverse impact on settlement procedures, the timely judicial resolution of tax cases, and the vigorous and even-handed enforcement of the tax laws by the Service and by a Tax Court already under severe stress from its docket.

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[1] H.R. 1095 and 2555 appear to impose a standard of strict liability, As such, they would exacerbate problems associated with any broadbased attorneys' fees measure.

COMMENTS ON THE EQUAL ACCESS TO JUSTICE ACT

In excluding Tax Court cases from its coverage, the Equal Access to Justice Act properly recognizes their unique nature and the fact that different treatment for fees and costs might well be appropriate. We believe that the Act's objective of facilitating access to the courts can best be met by encouraging administrative settlement of tax cases and that extending attorneys' fees coverage to the Tax Court would be counterproductive.

Ideally, we would prefer that the Equal Access to Justice Act's coverage of tax cases in the District Court and the Court of Claims be eliminated. The adverse impact on Service and judicial resources in handling attorneys' fees claims and the risk of encouraging litigation rather than administrative settlement of cases are even greater under the Equal Access to Justice Act than under H.R. 3262. However, because the Equal Access to Justice Act is in place and is to some extent experimental, and because the vast preponderance of tax litigation is before the Tax Court, we do not feel compelled to advocate modification of the Equal Access to Justice Act at this time. On the other hand, if a "bad faith" standard is enacted for the Tax Court, we would urge that it be adopted as the exclusive basis for an award of attorneys' fees in tax litigation not only in the Tax Court but in the District Courts and the Court of Claims as well.

CONCLUSION

The decision whether to provide for attorneys' fees in tax litigation requires balancing a number of competing considerations: Access to the judicial process and restraint of unwarranted Government action; timely judicial resolution of pending controversies; and proper enforcement of the tax laws. In our view, a broad-based attorneys' fees statute—regardless of how carefully drafted—would contribute only marginally to the objectives of access and restraint, while detracting materially from the objectives of timely dispute resolution and proper law enforcement.

We appreciate the opportunity to appear before you this morning and would be happy to respond to any questions you may have at this time.

Attachment 1

TAX COURT DOCKET (EXCLUDING "S CASES")

Year	Cases initiated	Cases disposed of	Year-end inventory
1967 (July to June)	6,857	7,482	10,376
1972 (July to June)	5,980	6,262	11,068
1977	8,576	6,921	18,335
1978	10,332	8,926	19,664
1979	11,800	8,596	22,868
1980	12,711	8,506	27,703
1981 [1]	19,600	9,600	37,703

[1] Projected

Approximately 2,000 cases involve so-called tax protesters (6.3 percent of the Tax Court's inventory).[1]

Approximately 8,000 cases consist of what the Service considers abusive tax shelter cases (24.29 percent of the Tax Court's inventory).

The Service estimates that during 1981, more than 35,000 cases will be settled in their entirety during administrative appeals prior to commencement of litigation.[2]

In June 1979, the jurisdictional limit for so-called "S Cases" was increased from $1,500 to $5,000.

In the vast majority of Tax Court cases, a significant number of additional issues had been raised on audit but were settled prior to commencement of litigation.

The number of "S Cases" filed in 1976 was 3,692; in 1980, 7,949 were filed.

Chairman STARK. Thank you. I have a couple of questions. I would like to ask the following question in view of this. We have received for the record a statement from the new chief judge of the

[1] Excluding so-called small (or "S") cases under code section.
[2] Excludes cases resolved in their entirety during the audit phase.

Tax Court, the Honorable Theodore Tannenwald, Jr. Although he questions fee awards generally in tax cases, he makes recommendations in the event we do decide to legislate in this area. One suggestion he makes is that the Government should be awarded attorneys' fees in appropriate cases where it prevails. It occurs to me that the Tax Court is a delightful place to get a low-interest loan, and stall the Internal Revenue Service for a long time before paying something that the litigant may really know that he or she is going to be liable for. In my legal terminology, here is Stark's Law No. 1: What is sauce for the goose is sauce for the gander. If we could find a standard that cuts both ways, it would make it fairer for both parties.

How do you view that proposed change, assuming we have legislation of this type?

Mr. EGGER. Mr. Chairman, first of all, on the standard itself, we have already stated that we think there is without question some rationale for awarding fees in the case of instances of bad faith on the part of the Government. And although we would hope such cases would be at a minimum, they certainly do happen.

On the other hand, we have right now some 2,000 cases in the Tax Court that we would classify generally as tax protester cases. These are cases that we believe are brought on spurious grounds, on really baseless arguments. While the Tax Court has the means of disposing of such cases fairly expeditiously, they do take up the court's resources and time, and I can think of no solid reason why the public should bear the cost of cases brought into the Tax Court by tax protesters simply to have a forum to espouse their particular theories.

Chairman STARK. The theory is they have a chance to come before this committee? Well, you would agree then that if there is legislation in this area, that it should cut both ways?

Mr. EGGER. As to legislation in the area, I think the standard should be bad faith and I think it should go both ways; absolutely.

Mr. SCHULZE. May I inquire at that point?

Chairman STARK. Sure.

Mr. SCHULZE. How would you describe bad faith?

Chairman STARK. That is exactly the question, if the gentleman would yield.

Mr. EGGER. Bad faith is sort of a term of art that has been interpreted in quite a number of cases by the courts in the past. And while I don't have in my mind a precise definition, counsel assures me that there would be much less of a problem trying to apply that kind of a standard than one of, say, reasonableness or some other type standard, since this one has in fact been interpreted by the courts in the past.

Mr. SCHULZE. Not being an attorney, if the gentleman will yield further, can you explain the difference between reasonableness and bad faith then?

Mr. EGGER. Yes; bad faith is a case where on the part of the Government, for example, we ought to know better. For example, if we applied the so-called 100-percent penalty in a trust fund case, where we were aware of information in the file showing that the individual was not a responsible officer, and we proceeded anyway, despite information that should have permitted us to resolve the

case without further pursuit of the taxpayer or perhaps in the taxpayer's favor. That can happen where there is a breakdown of communication, where there is simply a failure on the part of the Government to take into account information that is at its disposal.

Describing bad faith on the taxpayer's side it is a good bit easier. Examples can be found in any number of the so-called protester cases that have been brought before the Tax Court arguing constitutional grounds or gold standard issues and things of that kind that have long since been disposed of by the courts.

Mr. CHAPOTON. If I might add to that, I would on the taxpayer's side add the very serious problem of tax litigation instituted for purposes of delay, when it is pretty well determined that the taxpayer has no reasonable chance of success.

Chairman STARK. Isn't our bill gentler on you all than the one that will become law?

As I understand it, in the U.S. district court and the U.S. Court of Claims, if the Government sues me or I sue the Government and I win, then it is up to the Government to prove that the Government action was "substantially justified." You don't have to prove it was bad faith. You have to positively prove it was a good thing to do, if that is another way to say it.

What we are proposing here is the other way around. If you sue me or I sue you and I prevail, I have to come back and prove that your position was unreasonable. Isn't that an easier task for you? Doesn't that put more of a burden on me, the taxpayer, than the standards that are going into effect for the Court of Claims and the district courts?

Mr. EGGER. Yes; I certainly agree with that. Although there is a theoretical argument for putting the burden of proof on the Government on the basis that the Government has information at its disposal, the plain facts are, in our opinion, that such a burden would simply result in further expanding the volume of such claims, and would further take up the resources of the Service and the court in attempting to resolve those cases.

Chairman STARK. If I could go a step further, assuming that I have to prove, if the legislation is enacted as it is written, that the Service acted in bad faith or even that I have to prove it was unreasonable, do I as a taxpayer have adequate access to the evidence to prove my case, or do I have to get into a fairly long and costly discovery procedure and fight a whole lot of delaying motions that you would pursue to block me from getting that evidence? Have I got a hard row to hoe?

Mr. EGGER. One of the characteristics of proceedings in Tax Court is parties' agreeing on and exchanging information in advance so as to have all of the facts laid out before the court in a less formal fashion than in the typical discovery proceedings. We are concerned that if it is too easy to come by attorneys' fees for the taxpayer's counsel, there will be at least sort of an invitation to draw out the proceedings. While that intimates that some attorneys might be willing to expand the activities in order to enhance their fees, I just suggest that that could happen sometimes.

Chairman STARK. You raise an interesting point, and I don't know quite what I think your answer should be. But it occurs to me there could be two reasons for this kind of legislation: One, if I

were a badgered taxpayer who was being harassed, I would say this will get the IRS, by golly, and it will make the agents or the lawyers be a little more hesitant, before they could whisk innocent taxpayers off to court; or you could take the view that occasionally the fearless, honest, and hardworking, never failing bureaucratic system that is IRS makes a mistake occasionally, and we harm a citizen by unjustly causing that citizen to spend a lot of money defending himself or herself, and through this legislation we are merely trying to give them their money back and pay them back for the inconvenience we put them through.

I don't know which I think is the proper reason for this legislation—maybe it is a little bit of both, but aren't the incentives different? The citizen is either trying to make a case, as you say, in a protest suit, or save money by stretching out through litigation the time in which they have to pay. But your agents, it seems to me, are promoted and praised and kept on by the amount of money they collect, and probably not punished for their occasional loss in court.

I have two questions. One, if this legislation went into effect, would this really change the incentives in bureaucratic administration, I say that in not a pejorative sense but bureaucratic in the sense that you can't have agents on commission, so that there has to be an incentive for performing a job well, and that probably means collecting all the money we are owed as the Government. Will this change the way your agents would react? Are you afraid that they would back off, they would be more hesitant to file suits, or do you think that it would have little effect on the way you manage your collection efforts?

Mr. EGGER. First of all, Mr. Chairman, I would like to dispel completely any thought that our agents get rewarded on the basis of how many dollars they collect or how many cases they close or anything like that.

Chairman STARK. You wouldn't keep them very long if they lost cases, would you? Just like us, we don't stay around long if we lose an election.

Mr. EGGER. If the agent wasn't very good at picking issues, that would give me some indication of the quality of the agent's work. But in any event, we do not make evaluations of agents on the basis of enforcement results.

Let me respond to the point another way. There simply isn't any question about it; there are times when, with the 50,000 people or so that we have involved in enforcement, mistakes are made, there are breakdowns in communication, or there are judgmental errors. These things happen. When they do, we make every effort to correct them. We are the last ones to say they don't happen. Our people are not punished for judgmental errors in the sense that every time they make a mistake they are on the wrong end of the result of it.

By the same token, if people are in the habit of or continue to make those kinds of errors, then obviously there is something wrong with the way in which they perform. I do not believe this would change the way in which we handle such situations. When we make those kinds of mistakes, we think the taxpayer is entitled

to every consideration for the purpose of trying to correct the situation.

Chairman STARK. You can't give the legal fees back even if you wanted to, could you? You are saying: I really feel sorry for this poor widow and the children she adopted because they were orphaned and she has been evicted from her house and we took her to court unnecessarily and it was a mistake.

Do you have a procedure where you could really pay her anything?

Mr. EGGER. Yes, indeed. Let me give you an example. Occasionally in a seizure we pick up property that belongs to third parties, and inadvertently we don't realize it belongs to third parties and it gets sold. We have both the legal and the moral obligation to see to it that those people are compensated for that.

It is not always easy. but we do correct such situations.

Mr. SCHULZE. Just to follow up on that, are they compensated at actual value or the amount that it was sold for?

Mr. EGGER. Under the Internal Revenue Code, we are authorized, in cases of wrongful levy, to return the property levied upon, the amount levied upon, or the amount received from the sale.

Mr. SCHULZE. During the years I have been here, I have seen so many examples of abuses by the IRS that I think something has to be done to counterbalance those abuses. Perhaps percentagewise they are small, but it seems to me that there has to be some kind of an inhibiting factor put into the equation so that arbitrary suits and actions are not brought. If we are going to err, I think perhaps we should err on the side of the citizen instead of on the side of the Government.

Do you believe that the legislation we are considering today would cut down on the number of erroneous actions, which we agree have happened from time to time?

Mr. EGGER. I don't really think it is going to make that much difference, quite frankly, Mr. Schulze. As I said earlier, there are those cases of what would be termed bad faith that arise not because somebody wants to be vindictive or somebody wants to ride roughshod over the taxpayers, but through errors in judgment and so on, and when those things happen, I believe the taxpayer is entitled to be compensated.

If we require them to go into court and to expend funds in order to redress the wrongs, then certainly they should be compensated, and I believe strongly that so should the Government, to keep people from bringing spurious and bad-faith suits against the Government and using public resources in the same fashion.

Mr. SCHULZE. I have no problem with that, to go both ways.

Mr. EGGER. Under those circumstances I think we would support that kind of legislation, because I am satisfied that the Government is the loser in this whole business of bad faith, certainly at the present time.

Mr. SCHULZE. In that definition of bad faith, would you include an area where perhaps past cases settled in the IRS are in one direction, and the next one is going in an 180-degree direction, the exact opposite from a previous ruling or decision?

Mr. EGGER. That is so hard to respond to in other than a general fashion, because the circumstances and the factors that might

enter into administrative settlement of an issue in one case do not necessarily represent the position that we should take on that issue for all time.

There is a second aspect to that order to establish the law in certain complex issues from time to time, even though we lose, let's say, in one region, in one court of appeals, we want to litigate in another one just to determine whether or not there is a basis for carrying it on up to the Supreme Court.

Mr. SCHULZE. That is the point I am getting at.

Mr. EGGER. That is in the public interest, to establish what the law really is in those cases.

Mr. SCHULZE. We are also sometimes playing games with the taxpayer, just in order to do that.

Mr. EGGER. Well, I would like to think that we do not do that, but certainly we do not do so as a matter of policy. If it happens, it happens because of some individual miscarriage, some misguided act, or a breach of the policy rules of the Internal Revenue Service. I can assure you that that is not a matter of policy.

Mr. SCHULZE. I don't think that the majority of these abuses necessarily emanate from Washington. Are there other ways you can think of to eliminate some of the problems that you run into, without this or in combination with this type action?

Mr. EGGER. It is our policy to continue on a constant basis to remind the field organization of their responsibilities in terms of dealing with the public. Just the year before I came into this office, there was a significant change in policy with regard to seizures of property and to actions in connection with collections to preclude a recurrence of an unfortunate incident that happened in Alaska with respect to a seizure.

Mr. SCHULZE. Do you suppose that would have happened if there hadn't been so much publicity on that?

Mr. EGGER. In that individual case, I have to say, Mr. Schulze, that the only real way to judge that is to look at the entire record of that particular case. There were reasons on both sides, and while in the final analysis I would have to say that I think it was a poor judgment call on the part of the individuals involved, there was certainly nothing illegal about it, and certainly nothing that couldn't be supported. This is on the record by the U.S. attorney up there after the fact.

Mr. SCHULZE. In your opinion, are there any groups, as such, who would benefit more from this type of legislation? What I have in mind is perhaps the small business community who often feel extremely harassed by the IRS.

Mr. EGGER. I believe the instances of harassment that people talk about arise in the vast majority of situations, not from the normal examination and assessment process, but from collection, which is the whole process that takes place after the tax decision has been arrived at, even after Tax Court judgments in many instances, but certainly after the taxpayers have had full and ample opportunity to pursue their appeal rights. In the vast majority of these cases, such as in the trust fund cases, where small business people have withheld income taxes or FICA taxes and have failed to pay them over the egregious things happen when we seek to collect them.

We are working very, very hard to try to get out in front in those cases, and not allow the small businessman to get in so deeply that he can't get himself out. That, to me, is the way to solve the problem.

Mr. SCHULZE. That is good to hear because you are right, that is the way to solve the problem. Often the small businessman is not sophisticated enough to know how to handle these type of actions, and he feels that the entire weight of the Federal Government is coming down on him, and here he is alone, with nobody to defend him, and he is usually in a tenuous financial situation, and that is what brought about the problem.

Mr. EGGER. I have spent 30 years of my career in the private sector, including a great many dealings with small business, and so often the businesses are started on very, very thin capital, very, very tenuous capitalization, and the temptation sometimes is very great to use the withheld tax money because our procedures at the present time aren't good enough to identify that early on. Sometimes it takes months, sometime 6 or 8 months before we know that the particular business is behind, and then by that time the individuals have gotten themselves in so deeply that it is very hard for them to extricate themselves.

It is a very difficult problem because it is our obligation to represent the Government's interest, but by the same token I can recognize why this happens, and I am going to try my best to see to it that our procedures are developed so that we can minimize the number of times when this happens.

Mr. SCHULZE. I guess one of the problems involved in all of Government is the personalities of the individuals involved with these things, and I guess that is something that we can't legislate or do much about.

I thank you, Mr. Chairman. I thank the gentleman.

Chairman STARK. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you, Mr. Chairman.

I would like to thank the witnesses for a very constructive statement. I think you rightfully point out some of the problems with the legislation as it now stands—no requirement that the administrative remedies be exhausted, what do you do when there hasn't been timely disclosure on the part of the taxpayer and what amounts to bad faith on his side? I am also pleased to see that you would consider developing legislation where attorney's fees would be paid where there has been, through error or whatever, bad faith on the part of the Government.

It seems to me that your most serious objection to the bill is that it would open the floodgates to additional cases, and justice delayed is justice denied.

Why has there been such a tremendous increase in the caseload in the last 5 years?

Mr. EGGER. There are probably a whole series of factors. One is certainly the growth of tax shelter issues that have developed in the last 5 to 15 years. Tax shelters, as I have said publicly many, many times, has probably been America's largest growth industry in some long while, and so the proliferation of those issues has been a problem.

The second thing is that I think the American public, by and large, just feels more strongly about litigating, going into court. They are more willing, I believe, to litigate than they were before.

Finally, I think that the interest rate factor has had a lot to do with it. Fortunately, the Congress has seen fit to assist us in that respect as of next year, by equalizing the interest cost to what the marketplace would provide.

I think that there are things that both we and the Tax Court can do and are doing to speed up the whole process of closing out cases, hopefully before they get to docket status, and certainly to move them along as rapidly as possible thereafter.

We have had numerous conversations in recent weeks with the Tax Court, and the Chief Counsel of Internal Revenue is working along with our appeals people to see if there aren't further measures we can take to try to close those cases at an earlier stage. So while I can't be certain of all the reasons why the growth has taken place, certainly those are some of the principal ones, and we are working at it.

Mr. VANDER JAGT. I am wondering if, working with you, we couldn't develop a bill that addresses some of the problems that I think you very legitimately raise, and keeps the increase in litigation down to a minimum.

Over a dozen years ago I introduced a bill to provide attorney's fees to any person who litigated with the Government and prevailed in the end. I called it the David and Goliath bill.

In all the years that I have been in Congress, I have never done anything that touched off a greater wave of support, enthusiasm, and excitement than that David and Goliath bill. While it is true that justice delayed is justice denied, my concern back then was that a right that is surrendered often enough becomes a right that is lost.

I wonder if there wouldn't be a way in those cases where the IRS is clearly wrong, and the taxpayer was clearly right, or the taxpayer prevailed, to award the taxpayer his cost since it would further the public good.

Mr. EGGER. Well, as I said before, that cuts both ways.

Mr. VANDER JAGT. Yes; that is a very good and legitimate point.

Mr. EGGER. Then I believe we can and should work with you to try to develop such a bill. Perhaps "bad faith," as such, isn't the right term.

Mr. VANDER JAGT. And perhaps the word "prevail" isn't the right word either.

Mr. EGGER. Right, and so I think that we certainly could sit down and work with you and with your staffs in trying to develop criteria that would be workable and not add to the problem, because our concern is in the cases that are brought into that court for one reason alone, and that is to delay the proceeding, or to, as the chairman has said earlier, get a low-interest rate loan, or for some other reason, which means that the mere delay is a profitable thing for taxpayers in many ways, quite apart from the interest rate.

The Tax Court would be keenly interested in working out something that would keep the inflow to a bare minimum, recognizing

that litigation is one way in which we must finally resolve many, many complex issues that arise under the Internal Revenue Code.

Mr. CHAPOTON. Mr. Vander Jagt, if I might add, I think we ought to keep in mind that our American judicial system is that. Without the Government even being a party litigant, you might have an unjust claim brought against you, which means you have to pay your own attorneys' fees. The Internal Revenue Service does have a very elaborate administrative procedure that is essential to protect, and indeed most cases are settled at that level.

Mr. VANDER JAGT. I think your concerns are very, very legitimate.

Chairman STARK. Would you yield?

Mr. VANDER JAGT. In tax cases, the taxpayers' taxes are financing the Government case against him.

Mr. CHAPOTON. Right, and he feels like the other side has unlimited resources. I am afraid that is going to be true whether or not the other side has to pay his attorneys' fees. I think that probably will not diminish the enthusiasm in the great preponderance of cases that they should pursue. The taxpayer will then feel that, by golly, he is going to be reimbursed if he incurs all of these expenses. But in a great number of cases he is going to have a lot of risk going in because he doesn't know——

Mr. VANDER JAGT. Whether he is going to prevail or not, he is investing a lot. He has to feel strongly that he is going to prevail. You both have been very helpful and very constructive, and I thank you very much.

Chairman STARK. I would like to just follow up on Mr. Vander Jagt's point and the point you just made in response. In the testimony we are going to receive in a moment, the bar association has suggested that part of the legislation should be drafted to make sure that the taxpayer exhausts all the procedural remedies through your administrative processes, or if they elect not to—in other words, if they suddenly decide not to go through your administrative procedure and hop right into court, that they wouldn't get this award.

So there would be an incentive there for them to follow your procedures through, and also that if they are offered—I think the suggestion goes on—if they are offered a settlement from you, which is substantially what they get in court, or if it is even better, that therefore they wouldn't get the award either. And I guess you would agree—you are nodding your head—that if you happened to have this kind of legislation, these kinds of amendments would be something you would agree with.

Mr. CHAPOTON. They would be essential.

Chairman STARK. I would like to then ask the staff to provide you and the Commissioner with copies of the other testimony that will follow yours, and if you would go through that and respond to the subcommittee on those suggestions because I think there are very good suggestions that we will hear later today. Without objection we will then make your comments on that part of the record, because I think some impinge directly on the Service's administration of the tax laws.

Mr. EGGER. We will certainly be glad to do that.

Chairman STARK. Thank you very much. We appreciate your testimony.

Mr. CHAPOTON. Thank you, Mr. Chairman.

Chairman STARK. The next witness is Mr. John Nolan, chairman of the taxation section of the American Bar Association, accompanied by Mr. Andrew Singer, chairman of the Court Procedure Committee of the taxation section of the American Bar Association. We have your statement, Mr. Nolan, and without objection it will appear in its entirety in the record. You may proceed to summarize it or read it, however you are more comfortable.

STATEMENT OF JOHN S. NOLAN, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION, ACCOMPANIED BY ANDREW SINGER, CHAIRMAN, COURT PROCEDURE COMMITTEE, SECTION OF TAXATION

Mr. NOLAN. I will summarize.

I am John S. Nolan, chairman of the taxation section of the American Bar Association, an organization of 24,000 tax lawyers throughout the United States. The position of the American Bar Association is that the Tax Court as well as the U.S. district court and the Court of Claims should be authorized to award reasonable attorneys' fees and expenses to a taxpayer who prevails in a civil tax case.

Under existing law, under the provisions of the Equal Access to Justice Act, which becomes effective October 1, 1981, attorney fees and expenses may be awarded to a taxpayer in a civil tax case in the U.S. district court or the Court of Claims under certain conditions.

The American Bar Association considers that it should be made clear that such awards should also be made in the Tax Court, and that certain other deficiencies in the Equal Access to Justice Act and in bills which have been introduced to provide for award of attorney fees in tax cases should be rectified.

There is no justification for withholding attorney fee awards in tax cases in the Tax Court while they are being allowed in tax cases in the Federal district court and Court of Claims. We favor awards in tax cases in all instances under appropriate conditions. The Tax Court is the only forum in which taxpayers may litigate their tax disputes with the Internal Revenue Service without being required first to pay in full the amount of tax the Service alleges to be due. The Tax Court is, accordingly, the place where most taxpayers of moderate means and small businesses seek judicial review of IRS dealings. Exclusion of the Tax Court denies the benefits to the very class of persons whom Congress most wishes to help.

The Equal Access to Justice Act limits attorney fee awards to individuals having a net worth of $1 million or less, businesses and other organizations with a net worth of $5 million or less having 500 or fewer employees, and charitable organizations and agricultural cooperatives.

Bills under study by this subcommittee would eliminate this net worth test; Mr. Stark's bill, H.R. 3262, would substitute a $20,000 cap on such awards.

Chairman STARK. With the net worth test in there we wouldn't get any Republican votes. That was purely politics.

Mr. NOLAN. We strongly prefer a flat dollar limitation, such as the $20,000 cap in Mr. Stark's bill. Net worth determinations are complex and may embroil the courts in controversies as difficult as the substantive tax issues that were decided.

The Equal Access to Justice Act awards attorney fees and expenses unless the Government demonstrates that its position was "substantially justified" or that "special circumstances would make an award unjust." Mr. Chairman, your bill would, instead, require that the taxpayer prove that the Government's position was not merely incorrect but also "unreasonable." We urge the Congress not to adopt this latter approach. The term "unreasonable" is too vague a standard, and the burden of proof, in any case, should be on the Government, not the taxpayer. The reasonableness of the Government's position is more likely to be determined from Government records than from external sources, and if the Government has lost the case, it is fairest and most efficient to require the Government to establish that it satisfies an appropriate standard for allowance of such awards.

We urge, however, that Congress provide more extensive guidelines for such awards. We have included cases in our statement for the record in which awards would be justified and other cases in which awards would not be justified. For example, an award would be justified if the Government has previously lost a final decision on the legal issue in another forum and does not have a favorable decision in any other forum. An award would not be justified where the taxpayer's failure to cooperate in a reasonable administrative investigation left the IRS no choice but to litigate.

We are concerned that such awards will result in fewer administrative settlements of tax cases, and we urge that taxpayers, as a condition for obtaining such awards, be required to make a good faith effort to utilize the IRS appeals procedures before bringing their cases to court. There should be an exception only where the court finds that it would have been futile for the taxpayer to pursue his administrative remedies in the particular circumstances.

The Internal Revenue Service should be encouraged to take the initiative in proposing settlements in appropriate cases. A taxpayer should be denied an attorney fee award if he refuses a settlement offer as favorable as the court's final judgment unless the case involves a continuing issue which the Service refused to concede in prior years.

The Equal Access to Justice Act provides for an attorney fee award where the person in question is the prevailing party. This involves some special problems in tax litigation. Tax cases frequently involve more than one issue, and the most significant issue is not necessarily the one involving the most dollars. Your bill would clarify this matter in tax cases by defining a prevailing party as one who has substantially prevailed either with respect to the amount in controversy or with respect to the most significant issue or set of issues presented. We support this provision.

Mr. Chairman, I would just observe that there are many common threads in our testimony and in the testimony of the Government.

We, of course, differ at the bottom line, but we apparently both think that some of the suggestions the ABA has made would be most useful and important in any further legislative action on attorney fee awards.

I also would like to comment on whether this legislation will increase or make more difficult the Tax Court's existing docket problem. The most important reason that the Tax Court docket has increased to the extent that it has, as you pointed out earlier in these hearings, is that it is a form of tax shelter itself. Taxpayers could defer paying tax liabilities at interest rates of 9 or 12 percent when they were earning 17 or 18 percent on money market funds.

The Congress has corrected that problem for the future. The Congress, in the 1981 act has also taken some additional important actions that will impact on that docket. The negligence penalty burden has been increased, and quite appropriately so. A new overvaluation penalty has been enacted, and both of these will have significant effects on tax shelter cases. The Tax Court filing fee has been authorized to be increased, and the court will increase that fee in its regular cases from the present $10 to $60, which will have a significant impact on the so-called tax protester cases.

There are other things that can and should be done. Our section has been working at length, in conjunction with the American Institute of Certified Public Accountants and the IRS, in developing a process for audit of partnerships at the partnership level, so that the issue could not in all instances be litigated separately by every partner in any forum that he might choose.

The Government has suggested in its statement that section 6673 of the Code be beefed up. That section authorizes the Tax Court to award damages up to $500 against taxpayers who institute proceedings merely for delay. That is a worthwhile suggestion that deserves study. The problem should not be solved, however, by perpetuating the existing difficulty small businessmen and low-income taxpayers have in testing IRS determinations where they have exhausted their administrative remedies within the Service, and there is no justification for treating people differently where they bring their cases in the Tax Court, where the small taxpayer must bring his case, rather than in the district court or the Court of Claims.

[The prepared statement follows:]

STATEMENT OF JOHN S. NOLAN, CHAIRMAN, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to express the views of the American Bar Association on the important matter of attorney fee awards to taxpayers who prevail in civil tax litigation against the Government. My name is John S. Nolan and I am Chairman of the Association's Section of Taxation.

It is the position of the American Bar Association that the Tax Court, as well as the U.S. District Courts and Court of Claims, should be authorized to award reasonable attorney fees and expenses to a taxpayer who prevails in a civil tax proceeding. There are, however, some significant deficiencies in the Equal Access to Justice Act and in bills which have been introduced to provide for such awards in tax cases which should be rectified.

In the Equal Access to Justice Act, Congress has approved attorney fee awards against the Government on an experimental basis in many types of cases, including tax litigation. The provisions of the Act, which become effective for a three-year period beginning October 1, 1981, limit reimbursement to individuals having a net worth of $1,000,000 or less, businesses and other organizations with a net worth of

$5,000,000 or less or having 500 or fewer employees, tax-exempt charitable organizations, and certain agricultural cooperatives. Where a party eligible for reimbursement under the Act prevails in litigation with the Government, he is entitled to an award of attorney fees and other costs of the litigation unless the Government can demonstrate that its position was "substantially justified" or that "special circumstances would make an award unjust."

Although the draftsmen of the Equal Access to Justice Act clearly intended to bring tax cases within its scope (see S. Rep. 96-253, 96th Cong., 1st Sess. (1979), p. 3), a technical oversight may have excluded Tax Court proceedings (but not tax litigation in the District Courts and Court of Claims) from the provisions of the Act. The Act's authorization to award attorney fees against the Government is contained in section 2412 of Title 28 of the United States Code, which deals with U.S. Courts created under Article III of the Constitution, but the Tax Court was created under Article I of the Constitution (see section 7441, I.R.C. 1954) and is governed by provisions of the Internal Revenue Code that have not been expressly amended to authorize the Court to award attorneys fees.

We urge that prompt action be taken by Congress to clarify this situation by making clear that the Tax Court is authorized to award attorney fees in tax litigation under the same standards as are applicable in tax litigation in the District Court and Court of Claims. There is no justification for treating taxpayers differently in this regard depending upon the forum in which the tax dispute is heard. It would be doubly unfortunate if the Tax Court were not covered, for it is the only forum in which taxpayers may litigate their tax disputes with the Internal Revenue Service without first having to pay the tax which the Service alleges to be due. The Tax Court is thus the forum of choice for the overwhelming majority of taxpayers, particularly small businesses and individuals of moderate means, and its exclusion would deny the benefits of the Act to the very class of persons Congress most wished to help.

We are aware of three bills introduced in the House and referred to the Committee on Ways and Means in this session of Congress that provide for reimbursement of attorney fees in Tax Court as well as other tax litigation proceedings. H.R. 1095, introduced by Mr. Hinson, and H.R. 2555, introduced by Mr. Rousselot, would award attorney fees to prevailing taxpayers without any net worth test and regardless of whether the Government was able to show that its position, while not successful, was at least "substantially justified." H.R. 3262, introduced by Mr. Stark, would also eliminate any net worth test but would place a cap of $20,000 on the amount of attorney fees and other expenses that could be recovered from the Government and would make it substantially more difficult for taxpayers to recover by requiring them to prove that the Government's position was not mercly incorrect but "unreasonable".

While we recognize that limits on reimbursement of attorney fees may be necessary at this experimental stage, some restrictions are clearly more objectionable than others. In general, we think a maximum recovery amount, such as the $20,000 limitation in H.R. 3262, is preferable to a net worth test such as that contained in the Equal Access to Justice Act. Even a more affluent taxpayer may be forced to accept an arbitrary IRS position when the costs of litigation, absent an attorney fee reimbursement provision, would exceed his recovery whether or not he is successful in court. Moreover, determining the net worth of an individual or organization may embroil the court in controversies that are as difficult as the substantive tax issues it has just decided. Congress should avoid placing restrictions on the recovery of attorney fees that would significantly prolong tax controversies and divert judicial resources from an already overburdened tax litigation process.

For the same reason, we think it unwise to condition recovery of attorney fees on a showing by the taxpayer that the Government's position in the case was "unreasonable." A term so vague invites controversy, and leaves the court virtually without standards. For example, is it unreasonable for the Internal Revenue Service to adopt a policy of litigating every case involving a particular issue (as it did with family partnerships and professional service corporations a number of years ago) until it obtains a result in accord with its interpretation of the Internal Revenue Code? Should a taxpayer bear the burden of litigation instigated or continued by the Government as a "test case" for the purpose of providing judicial guidance to the Internal Revenue Service in its administration of the tax laws for the benefit of all taxpayers?

The "substantially justified" standard of the Equal Access to Justice Act is equally vague, but at least places the burden of proof on the Government, which is in the best position to explain why it brought or defended the case. If the taxpayer is required to prove the "unreasonableness" of the Government's position, he will likely have to seek his proof from the Government's records of the process it

followed in formulating its position. Such materials might be available, however, only through discovery, and the Government is likely to claim that a substantial portion of them are privileged. This may well produce additional litigation involving discovery requests for internal memoranda, communications, and depositions of, or interrogatories to, Government personnel and Government resistance to production of documents or other discovery by private litigants through assertions of privilege.

Accordingly, if the Congress decides to retain a concept of "unreasonableness" or lack of "substantial justification" as a condition of fee awards in tax cases, the burden of proof should be on the Government which, after all, has by definition lost its case against the taxpayer. Moreover, Congress should provide policy guidelines for the courts to apply, either in the statute or committee reports. For example, Congress might specify that the following situations would entitle a prevailing taxpayer to a fee award.

(1) The Government has previously lost a final decision on the legal issue in another form and does not have a favorable decision in any other forum.

(2) A reasonable investigation of the facts would have demonstrated to the Government that it was unlikely to prevail.

(3) Existing law and precedent, even if not directly controlling, made it unlikely that the Government would prevail.

(4) The Government's position is contrary to a published administrative position or longstanding administrative practice.

(5) The facts and circumstances of the case demonstrate that the Government has attempted to use the costs of litigation to extract taxpayer concessions which were not justified by the facts of the case.

On the other hand, a fee award ordinarily would not be appropriate where the taxpayer's own failure to cooperate in a reasonable administrative investigation leaves the Internal Revenue Service with no choice but to litigate his tax liability. The Service would also be "substantially justified" in defending a Treasury regulation in court in most cases, even though the court ultimately decides that the regulation is invalid. Moreover, in general, the "substantially justified" standard should not be interpreted so rigidly as to discourage the Government from litigating reasonable legal positions merely because they are novel or controversial.

It must be acknowledged that taxpayers will be less likely to seek administrative settlements before going to court if attorney fees and other costs incurred in proceedings before the Internal Revenue Service are not reimbursable. Unless Congress intends to reimburse taxpayers for costs incurred in pursuing administrative appeals within the Internal Revenue Service, some method should be devised to insure that taxpayers make a good faith effort to utilize the Internal Revenue Service's appeals procedures before bringing their disputes to court. Neither the Equal Access to Justice Act nor the attorney fee bills pending before the Ways and Means Committee address this issue, however.

Taxpayers might be required to exhaust their administrative remedies in the Service as a condition to receiving attorney fee awards. Taxpayers who do not make good faith efforts to have proposed deficiencies reversed or reduced in the Revenue Service's Appeals Office should be allowed to proceed in court if they wish, as under present law, but they should not be permitted to recover attorney fees from the Government in such cases unless the court finds that it would have been futile for the taxpayer to pursue his administrative remedies under the circumstances of the particular case.

The Internal Revenue Service should also be encouraged to take the initiative in proposing settlements in appropriate cases. A taxpayer could be denied recovery of his attorney fees upon a showing that he had refused an offer of settlement from the Internal Revenue Service on terms no less favorable to the taxpayer than the terms of the court's ultimate judgment unless the taxpayer could show that the case involved a continuing issue which the Service had refused to concede for future years. This approach is analogous to the rule governing assessment of costs in Federal District Courts under Rule 68 of the Federal Rules of Civil Procedure.

Finally, the term "prevailing party" as used in the Equal Access to Justice Act may give rise to problems of interpretation in the special circumstances of tax litigation. Tax cases frequently involve more than one issue, and the most significant issue is not necessarily the one involving the most tax dollars. For example, so called "timing" issues (whether an item is deductible in one year rather than another) are likely to be less important to a taxpayer than an issue as to whether an item is taxable at all, even though the timing issue may appear to involve more money. H.R. 3262 would make this distinction clear in tax cases by defining a prevailing party as one who has either substantially prevailed with respect to the amount in controversy *or* has prevailed with respect to the most significant issue or

set of issues presented. However, even without such a standard in the Equal Access to Justice Act, we suspect that courts will probably reach the same result.

In summary, while the American Bar Association believes that it is reasonable to award attorney fees and expenses to prevailing taxpayers in civil tax litigation with the Government, it is imperative that the authority to make such awards be unequivocally extended to the Tax Court where the average taxpayer typically brings his tax case. We believe that in general it is unwise to impose conditions on awarding attorney fees beyond the requirement that the taxpayer prevail in his case, although an exhaustion of the administrative remedies requirement may be necessary to encourage settlements and avoid unnecessary litigation. In all events, any requirements in addition to the prevailing party standard should be easily applied by the courts so as not to protract the litigation and further burden the tax litigation system.

Mr. Chairman, we appreciate the opportunity of participating in these hearings and trust that if we can be helpful in further consideration of this important matter you will feel free to call upon us. Certainly we stand ready to work with you and the Subcommittee staff and look forward to doing so.

Chairman STARK. A couple of questions occur to me, Mr. Nolan.

I gather, assuming we get this legislation moving along, that the burden of proof is going to become a major question. It is my understanding that five or six States have taken similar types of, or are experimenting with, similar types of recovery of legal fees where the defendant prevails, the initial defendant.

Is there a clear pattern of burden of proof in all of those States, and in the Federal law?

Mr. NOLAN. I can't speak to the States' cases because I am not familiar with those.

Chairman STARK. It will be interesting to me to see if lawyers agree that there is a pattern across the country of where the burden of proof goes. It would help me as a layman to see whether there is some unanimity on who should bear the burden of proof.

Mr. NOLAN. We will make a quick study of that and submit a letter.

[The following was subsequently received:]

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1981-1982
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January 6, 1982

The Honorable Fortney H. Stark
Chairman, Subcommittee on
Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
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Attorney Fees

Dear Mr. Chairman:

During my appearance before your Subcommittee on behalf of the Section of Taxation of the American Bar Association on the matter of attorney fee awards to prevailing taxpayers in tax cases, I was asked whether there is a clear pattern of burden of proof in other Federal and state statutes which award attorney fees to prevailing parties. I agreed to respond to this question after we had an opportunity to study the many Federal and state statutes involved and the applicable precedents, if any.

After reviewing dozens of statutes providing for attorney fee awards, our Court Procedure Committee found no clear pattern on burden of proof. Some of the statutes provide attorney fees automatically to a prevailing plaintiff, without further hearings except as to the amount of the award. Clayton Act, 15 U.S.C. §15; Fair Labor Standards Act of 1938, 29 U.S.C. §216(b). See also Christiansburg Garment Co. v. Equal Opportunity Employment Commission, 434 U.S. 412 (1978), p. 415 fn. 5. Other statutes, such as the Civil Rights Act of 1964, 42 U.S.C. §2000e-5(k), and the Employee Retirement Income Security Act (ERISA), 29 U.S.C. §1132(g), commit the award of attorney fees to the sound discretion of the court. Still others provide for an award of attorney fees only under special circumstances: e.g., Legal Services Corporation Act, 42 U.S.C. §299E(f) (Award must be based on a finding that action was commenced or pursued for the sole purpose of harassment or that the plaintiff maliciously abused legal process); Clean Air Act, 42

U.S.C. §7413(b), (award must be based on a finding that the Government's action was "unreasonable"); patent infringement statute, 35 U.S.C. §285 (award must be based on a finding that the case is "exceptional").

Where a court has discretion to award attorney fees, the standards applied by the court and the burden of demonstrating entitlement to such fees depend upon the broader purposes for which Congress enacted the statute. For example, the Supreme Court has held that, to implement the Congressional intent of encouraging plaintiffs to act as "private attorneys general" in vindicating Congressional policies under the Civil Rights Act of 1964, a prevailing plaintiff should ordinarily recover attorney fees under the Act unless special circumstances would render such an award unjust. See Newman v. Piggie Park Enterprises, 390 U.S. 400 (1968). The burden of proof is on the defendant to demonstrate special circumstances that would render unjust an award of attorney fees to the prevailing plaintiff. See Williams v. Miller, 620 F.2d 199 (8th Cir. 1980). See also Morrison Grain Co., Inc. v. Utica Mutual Insurance Co., 625 F.2d 1356 (5th Cir. 1981). On the other hand, the Supreme Court has also held that attorneys fees should be awarded to prevailing defendants under the same Act only where the plaintiff's action is found to be "frivolous, unreasonable or without foundation". See Christiansburg Garment Co. v. Equal Opportunity Employment Commission, supra, 434 U.S. at 421.

Ordinarily, the burden of persuading a court to exercise its discretion to award attorney fees, or of demonstrating the existence of special circumstances on which an award of attorney fees is conditioned by statute, should rest with the party seeking such fees. While this seems generally to be the case, the Equal Access to Justice Act, 28 U.S.C. §4212, which now applies to most litigation between the Federal Government and its citizens (including tax litigation in the District Courts and Court of Claims), awards attorney fees against the Government unless the Government can show that its position was "substantially justified" or that special circumstances make an award "unjust". See H.R. Rep. No. 96-1418, 96th Cong., 2d Sess. (1980), p. 10; S. Rep. No. 96-253, 96th Cong., 1st Sess. (1980), p. 6.

It is the position of the Section of Taxation that attorney fees in tax cases should be awarded to any taxpayer who substantially prevails in court, thus avoiding burden of proof issues and more importantly the time-consuming and expensive discovery procedures and hearings which may accompany inquiries as to whether a position was "reasonable" or "substantially justified". On the basis of our study of other statutes, however, we cannot say that there is any clear pattern which dictates an allocation of the burden of proof to one side or the other.

Sincerely,

John S. Nolan

John S. Nolan

Chairman STARK. Are there standard words like significant or reasonable? To me, if there are not any, I liked your list, of cases in which fees should be awarded. Maybe the legal scholars have enough of an understanding of those words so a judge and attorneys would get some kind of an agreement.

Is there enough scholarly background as to what is reasonable?

Mr. NOLAN. Well, there is common law, but it is not necessarily useful in this context. We have made some specific suggestions, and I am sure that the collective minds of the Treasury Department, the IRS, the Bar Association and other groups are good enough to enlarge that list. What the courts need is some guidance as to cases in which they should and should not award attorneys' fees, and it is entirely appropriate for the Congress to provide that guidance.

My own feeling is that the courts are going to award attorneys' fees only in cases where they are really justified using the kind of the seat-of-the-pants reactions that you or I might have as to when they are justified.

The Government by definition has lost the case. It is not unreasonable to ask the Government to prove then that in order to award attorneys' fees it must show substantial justification for its position. Indeed, there are many instances in which they will be able to show substantial justification.

Chairman STARK. Would you reverse that? There has been some discussion that the Government should go in and have the ability to ask for reimbursement for its costs, where you get somebody that uses the court system as a float and files a lawsuit to stall. The Government prevails. Should I then have the burden of proof that I was not being capricious or unreasonable?

Mr. NOLAN. I do not think that the proper answer to that problem is an award of attorneys' fees to the Government. As has been discussed, there is a provision in section 6673 of the Code today which authorizes the Tax Court to impose a penalty for cases where the taxpayer——

Chairman STARK. It sounds like a good gamble to me, $500 versus $2,500. Let's get away from the Government for a minute and assume that they are two private parties in State courts where fee shifting statutes are in effect. I would assume that those laws cut

both ways. So if you then bring it back into Federal court where one party is the Government, I would think that the Government should be able to collect fees so that there would be some disincentive on my part as a citizen from using the courts unreasonably, stalling or as in protests. But I am just saying——

Mr. NOLAN. The courts have a wide range of discretion to deal with those cases. They can dismiss cases by judgment on the pleadings where the case obviously has no merit. Do not underestimate the ability of the courts when those problems build up to find appropriate solutions to them. They will find them. Under the Equal Access to Justice Act, the Government may avoid and award attorneys' fees to the taxpayer by proving substantial justification for its position. That is a considerable opportunity for the Government to avoid awarding fees in cases where they should not be awarded, as suggested in our statement. There are other solutions to the protester case problem, such as increasing the filing fee, the interest rate.

Chairman STARK. How about the stalling?

Mr. NOLAN. The stalling, the courts have many opportunities to deal with taxpayers who deliberately stall and they will rise to that challenge.

Chairman STARK. I gather you are saying that you do not like the mirror image idea, that it ought not to apply to the Government, where the Government is awarded a fee or a fine when the citizen is the plaintiff and loses?

Mr. NOLAN. The most important characteristic of our income tax system is that it really is a self-assessment system, and it depends on taxpayer confidence. This particular problem is one which goes to the heart of that system. Do taxpayers think that they are being treated fairly by their Goverment? If they are unable to test Government determinations after they have exhausted their administrative rights, they feel that they are not being treated fairly because of the burdens that are imposed upon them in costs and attorneys fees. I do not, however, see that as a two-way street. It seems to me, if anything, the opposite is true.

Chairman STARK. You are saying that this is just not an argument over whose grass is on which side of the fence and two farmers fighting in court, but this is a case where one person, the Government in this case, has an advantage? There ought to be a different set of standards.

Mr. NOLAN. The Government loses an issue in three or four circuits. It is an important issue and the Government wants to pursue the issue to develop a conflict and get it to the Supreme Court. Should a small taxpayer suffer the burden of the Government taking that action, because the Government wants to establish a general principle? My answer to that is no. That burden should not fall on the taxpayer. That is a public interest decision that the Government has made. If the Government in those circumstances chooses to litigate the issue, so be it; but the taxpayer ought to be reimbursed for his attorney fees.

Chairman STARK. Let's enlarge on one of the Fortune 500's, or say an immense utility is involved with the Government, and the Government has prevailed. Part of the utility wants to stall. Let's say it is a huge award that has to go to all of its customers, but it

is cheaper to stall. It is cheaper to pay their in-house attorneys to keep the thing going for a couple of years and pay that money out 2, 3, 4 years hence in cheaper dollars. That is a management decision.

They lose, and the Government finally prevails. Our sympathies might be less for this huge corporation who are denying rightful award of penalties to citizens of modest means.

Shouldn't they have to pay attorney's fees, so to speak, or Government costs? Isn't the reverse true?

Mr. NOLAN. That is a rare case in this world. There may be such cases. I suspect that if there are, they are rare because the Government has many opportunities to file motions to force the issues to be brought to a head, for the trial to be held in a timely fashion, and otherwise for the case to be disposed of in a timely fashion. I do not think that is a serious problem, and I would hate to see a rule written around those very unique cases.

Chairman STARK. Thank you very much.

I would appreciate whatever information you could give me on how the burden of proof issue is being decided on these State laws that are on the books.

The information will be made part of the official hearing record.

Thank you.

Our next witness is Mr. Frederick Lewis of the Federal Tax Division of the American Institute of Certified Public Accountants, who is a partner in A. M. Pullen & Co. of Greensboro, N.C.

Mr. Lewis, we have your prepared testimony which will be made a part of the record in its entirety.

You may proceed.

STATEMENT OF FREDERICK E. LEWIS, MEMBER, FEDERAL TAX DIVISION, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. LEWIS. Thank you, Mr. Chairman. I am Frederick Lewis, a C.P.A., practicing as a tax partner with A. M. Pullen Co. in Greensboro, N.C.

I am speaking today on behalf of the American Institute of C.P.A.'s, which has a membership of approximately 175,000 nationwide, many of whom practice taxes.

Specifically, I am a member of the Committee on Scope and Management of a Tax Practice. Generally, the AICPA supports the proposition of reimbursement of fees and expenses of representatives in tax controversies.

Legislation proposed to date dealing with the reimbursement of such fees have focused, however, on litigation involving tax matters and primarily with attorney fees. The AICPA would respectfully request that any legislation proposed for reimbursement of fees and expenses in connection with the representation of a taxpayer in a tax controversy should provide for the reimbursement of fees and costs incurred at the administrative Internal Revenue Service level, as well as those incurred at the court and pretrial level.

To provide for reimbursement of fees and costs connected with tax litigation only could promote evasion of the Internal Revenue Service administrative appeal procedure in favor of litigation.

Bypassing Internal Revenue Service administrative procedure would be inefficient and costly for all parties concerned.

As has been indicated in previous testimony, court calendars are clogged with numerous cases and the already time-consuming processes could take even longer. The Government would have to wait to get its rightfully owed tax and the taxpayer has an unconcluded matter which could have a detrimental effect on future business decisions.

In addition, fees and costs reimbursed should include not only those of attorneys but certified public accountants, as well as other necessary professionals or agents. For example, C.P.A.'s routinely render service for tax advice, tax planning, tax return preparation and represent clients through all levels of the Internal Revenue Service administrative processes.

Chairman STARK. Could I interrupt you there? Aren't C.P.A.'s allowed to practice before the Tax Court without being admitted to the bar?

Mr. LEWIS. That is true.

Chairman STARK. I can understand that. In other words, you are seeking a fee for appearing and representing a client before the Tax Court, because isn't that the only place that a nonlawyer can practice, in effect, before a court?

Mr. LEWIS. That is correct. My own firm and many of the larger firms, however, do not practice before the Tax Court.

Chairman STARK. I see, OK, thank you.

Mr. LEWIS. That is correct. C.P.A.'s have a continuing involvement with their client's financial tax matters, and in many instances they have prescribed the tax treatment which results in the consulted issue.

The C.P.A., then, in most circumstances, would be the logical representative for the taxpayer to employ to handle the tax controversy at its initial stage, during the IRS agent's examination and through the IRS appellate procedure.

Although C.P.A.'s render assistance to attorneys during pretrial conferences and actual tax litigation, the C.P.A. is likely to have his or her greatest involvement representing the taxpayer before the IRS and to the point of trial. These fees can be very substantial and in many cases might be more substantial than the attorney's fees and expenses that deal with the actual trying of the case.

In other words, by the time the controversy reaches the court, substantial fees and expenses have already been incurred. Therefore, to accomplish the desired protection for the taxpayer, it would seem appropriate then that the reimbursement commence at the Internal Revenue Service level.

The question obviously as presented is how much or at what point you start counting the fees and expenses for purposes of reimbursement. It would appear that the controversy has been locked in, or that IRS has taken a position with the issuance of their 30-day letter. The 30-day letter notifies the taxpayer that he or she has 30 days to respond, normally in written form, to the proposed deficiencies asserted by the Internal Revenue Service.

Prior to the time of the issuance of the 30-day letter, IRS would be examining records, engaged in factfinding, and professional fees

incurred to deal with this activity would thwart the idea of reimbursement.

We believe that taxpayers should be free to choose from professionals qualified to represent them before the Internal Revenue Service and the Tax Court. "Treasury Circular 230" permits taxpayers to be represented by attorneys, C.P.A.'s and other enrolled agents.

Finally, to permit reimbursement of fees of attorneys only would place other tax professionals at a competitive disadvantage in representing clients and might result in the unwarranted conclusion that attorneys are the only approved practitioners in such situations. This could affect practitioners in other areas of tax practice by encouraging clients to use the services of an attorney in case a dispute with the Government should arise because attorneys appear to be approved.

I thank you for the opportunity to testify, and I will respond to any questions you might have.

[The prepared statement to follows:]

STATEMENT OF FREDERICK E. LEWIS, MEMBER, SCOPE AND MANAGEMENT OF A TAX PRACTICE SUBCOMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Good morning! My name is Frederick E. Lewis, and I am a partner in the Greensboro, North Carolina office of the CPA firm of A. M. Pullen and Company. I am a member of the Scope and Management of a Tax Practice Subcommittee of the Federal Tax Division of the American Institute of Certified Public Accountants and am here today representing that organization. The AICPA is the national organization for more than 175,000 CPAs, many of whom are involved in tax practice.

The AICPA supports the objectives of the legislative proposals to reimburse fees of representatives in tax controversies. We believe that in many cases such reimbursement is necessary to provide equal representation and justice to taxpayers, and that this is necessary to the fair and efficient operation of our tax system.

The AICPA urges the Subcommittee to include reimbursement of fees and costs of administrative appeals to the Internal Revenue Service in this legislation. Failure to do so will encourage taxpayers to bypass a possibly simple and productive method of resolving their problems in favor of litigation, simply because their costs may be recovered if they prevail. This greater use of the courts will naturally clog court dockets, will cost the taxpayer and the government additional money, and will delay resolution of contested issues. The complexity, delays, and uncertainty involved in litigation may put the taxpayer's business (and possibly the taxpayer) under unnecessary stress and will delay the payment of tax or receipt of a refund by the taxpayer.

We believe that fees and expenses should be covered from when the taxpayer receives a 30 day letter from the IRS. This letter notifies the taxpayer that he or she has 30 days to respond in writing to the proposed deficiencies asserted by the IRS. Prior to receipt of the 30 day letter, the IRS would be examining records and engaging in fact finding, and professional fees incurred to deal with this activity would not seem to be included in the spirit of the bills which have been introduced. The issuance of the 30-day letter signals the beginning of a controversy between the IRS and the taxpayer.

The AICPA also urges the Subcommittee to clearly include the fees of CPAs, as well as attorneys, in reimbursable fees and costs. CPAs represent taxpayers before the IRS and before the Tax Court. This area of practice serves the public well and is firmly established in the law, in the Tax Court's rules of practice, and in the Department of the Treasury's Circular 230 which regulates practice before the IRS.

CPAs routinely render services for tax advice, tax planning, tax return preparation and represent clients through all levels of the Internal Revenue Service administrative process. They have a continuing involvement with their clients' financial and tax matters. In many instances CPAs have prescribed the tax treatment which results in the contested issue. The CPA then, in most circumstances, would be the logical representative for the taxpayer to employ to handle the tax controversy at its initial stages, during the IRS agent's examination, and through the IRS appellate procedure. Although CPAs render assistance to attorneys during pre-trial conferences and actual tax litigation, the CPA is likely to have his or her greatest

involvement representing the taxpayer before the Internal Revenue Service and to the point of trial. These fees can be very substantial and in many cases might be more substantial than attorney fees and expenses dealing with the actual trying of the case. In other words by the time the controversy reaches the court, substantial fees and expenses have already been incurred.

We believe that taxpayers should be free to choose from among professionals qualified to represent them before the IRS under Circular 230 which permits taxpayers to be represented by attorneys, CPAs, or enrolled agents, and to represent them before the Tax Court under the courts rules which permit attorneys and CPAs to qualify to practice.

To permit reimbursement of fees of attorneys only would place other tax practitioners at a competitive disadvantage in representing clients in disputes and might result in the unwarranted conclusion that attorneys are the only "approved" practitioners in such situations. This could also affect practitioners in other areas of tax practice by encouraging clients to use attorney services in case a dispute with the government should arise or simply because attorneys appear to be "approved."

Thank you for this opportunity to testify. I would be happy to respond to any questions you may have.

Chairman STARK. I think I certainly would have no quarrel with awarding accountants attorney's fees when they represent taxpayers in tax litigation. But I think the way my bill is drafted, if a CPA were in the Tax Court, they would be entitled to those fees.

You are covered there. The question on administrative proceedings——

Mr. LEWIS. May I respond to that? The fees at that point, it has been my experience that C.P.A.'s are involved in providing information.

Chairman STARK. That would go through the lawyer's bill.

Mr. LEWIS. That is correct. I don't know how many C.P.A.'s are actually involved in representing taxpayers before the Tax Court. That is normally an invasion of another professional.

Chairman STARK. For the part where we get to the Tax Court, I think you are covered, either through the law firm billing, you billing the law firm and they billing the client, or in the actual representation of the client in court. That would not be precluded under my bill. But at the administrative level, I run into a couple of problems.

The first is one that I am not sure that your association would like the Stark rule No. 1, the old sauce for the goose and gander rule.

If you made a mistake on the tax return, and argued it through the administrative process, say, up one or two levels and recognized your mistake, would you be willing to pay the Government's cost of tolerating somebody arguing an error up through an administrative procedure?

Mr. LEWIS. I don't know if the American Institute has taken a position on this.

Chairman STARK. H. & R. Block would.

Mr. LEWIS. When a businessman decides to take the IRS to task, he has to consider all the costs involved. I have been involved in many cases where the expenses at that level far exceeded the expenses and fees of trying the case.

Chairman STARK. Aren't most issues that are not clear-cut mistakes, for instance, not situations where the date was wrong, but those that go through the administrative procedure, negotiated or settled out in some kind of compromise?

Mr. LEWIS. Correct.

Chairman STARK. That is where I have the problem. Invariably, there will be some questions of judgment, perhaps more than fact, about how much of this ought to be allowed or ought not to be allowed, and it is usually settled, and I don't know how you would assess in those cases who won and who lost.

Mr. LEWIS. In that circumstance, I wouldn't think it would be appropriate to invoke this type of legislation. I would think that the only way that a determination can be made as to whether the Internal Revenue Service took an unreasonable position is by a court. I don't think the Internal Revenue Service can make that decision.

Chairman STARK. In other words, as under the previous suggestion you would agree that all administrative remedies be exhausted first. Your firm then represented the client in these proceedings, and your offers of settlement kept getting turned down. You as a C.P.A. firm or your client's attorney still felt that the Service was wrong, that you will take the case to Tax Court. Your client prevails in the Tax Court, whips the Government. Then you want that $20,000 to be used not only for attorneys, but to go all the way back down to the part of the procedure that you were involved in?

Mr. LEWIS. That is correct, and that determination would be made by a court.

Chairman STARK. As to what share you should get and what share the attorney should get.

Mr. LEWIS. That is correct.

Chairman STARK. You are not suggesting that you should be awarded fees if it is something you resolved in the field office, for instance, how much the automobile was used for business or commuting?

Mr. LEWIS. That couldn't be handled at all that way.

Chairman STARK. I understand.

Thank you very much.

Are Mr. Bell and Mr. Davis here?

If I could get you both up at the same time, I will let you testify separately, but we have room for two people at once.

Thomas D. Bell, Jr., is the executive vice president of Citizen's Choice, and Edwin I. Davis is a C.P.A. from Houston, Tex.

We would ask Mr. Bell to testify first. We have your statement and without objection it will appear in full in the record. I would ask if you would summarize it for us. Go right ahead.

STATEMENT OF THOMAS D. BELL, JR., EXECUTIVE VICE PRESIDENT, CITIZEN'S CHOICE, INC.

Mr. BELL. Thank you, Mr. Chairman.

On behalf of the 70,000 members of Citizen's Choice, it is a pleasure to be here today. We appreciate your allowing us this opportunity.

I am Thomas D. Bell, Jr., executive vice president of Citizen's Choice. Since many of the previous witnesses have spoken about the technical aspects of the bill let me, instead, focus on the perceived relationship between taxpayer and Service.

Citizen's Choice recently completed a study called the Citizen's Choice National Commission on Taxes and the Internal Revenue Service. During an 18-month period we held 10 hearings through-

out the United States in major metropolitan areas, and collected written and phoned testimony. We had a taxpayers hotline where individual taxpayers could call and express their opinion about the IRS, either specifically about a problem they might have, and you can imagine what that was like, or in a general sense about how the Service went about its business. We found out some very interesting things from the testimony we received.

The commission was made up of a panel of experts, including academics, tax lawyers, C.P.A.'s, people out of Government, and small and large business. They evaluated all the information we collected and put out our report. I have a copy here for you today, and I will take the liberty of forwarding copies to the members of your committee.

One of the recommendations we made was the establishment of some sort of reimbursement system. Therefore, we are very supportive of your legislation or like legislation which would provide taxpayers with a reimbursement mechanism should they be proven substantially correct in a disputed tax matter.

We learned from our study and the 6,000 pieces of testimony we collected was that the relationship between taxpayer and Government is not good. It is rapidly declining and bordering on the dangerous stage. We feel the principal reasons for this are threefold. One is the Internal Revenue Services' attitude of presumed guilt on the part of the taxpayer.

Our witnesses and their testimony clearly demonstrated that it was not the fact IRS agents were uninformed or stupid, though they sometimes were, or that agents treated them poorly, though they sometimes did, but in the vast majority of cases, they did not. It was their attitude of presumed guilt under almost all normal circumstances. The agent would look at the taxpayer and say: "You owe $956; pay it, please," and generally they are not interested in any reasoning on the part of the taxpayer, so they foster this attitude of presumed guilt.

The second major area was fear. Fear is clearly a major motivator on the part of most taxpayers for payment. Ours is a voluntary system and it has traditionally been the best voluntary system of tax collection in the world. This whole voluntary concept, however, is in jeopardy because the prime motivator on the part of the Service and the taxpayer is fear.

This fear causes many taxpayers to overpay. They refuse to go into any sort of ongoing, complex, confusing processes with the Service or the courts in order to collect money that might be owed them, or to avoid paying money which they do not owe. Repeatedly, in literally hundreds of instances, tax practitioners, C.P.A.'s, lawyers, and individual taxpayers, particularly small business people, would say that: "We knew we were right on this particular $2,000 issue, but were advised by counsel not to pursue it because it would cost us more in legal accounting fees to pursue the issue than it would to win the case, so it didn't make much sense to us from a bottom line standpoint to pursue it."

We had former agents admit that more times than not they received payment or an agreement for payment between taxpayer and IRS because they knew the taxpayer wouldn't take it to court,

because he couldn't afford to take it to court. This is an obvious injustice in the system.

Mr. Egger and the IRS seem to agree an injustice exists. They even seem willing to resolve the injustice as long as it doesn't cost the Government any money or mess up any of their present procedures. This is unconscionable. To say our present budget problem is a reason to not give the small businessman or individual taxpayer a fair shake is reprehensible in our opinion.

Harassment, which was discussed here earlier, where one of the committee members asked for a definition. Harassment in the minds of the taxpayers is not just seizure of property. It is the attitude of the agent or the Service from the first contact through the last contact. It is this whole presumption of guilt and the fact the average taxpayer feels like that under the David-and-Goliath analogy Mr. Vander Jagt used don't have a chance.

The IRS has demonstrated repeatedly that they are not sensitive to the feelings of the average taxpayer. It is the responsibility of the Congress, who is very sensitive to the average taxpayer's feeling, to protect them from any overt, unfair activities on the part of the Service or the Government in general.

Toward this end, we urge the committee to send to the Congress reimbursement legislation, Mr. Chairman, which puts the individual taxpayer on equal footing with major corporations and small business on equal footing with big business. Legislation which allows them to pursue their rights which are or should be guaranteed under our system of government. If you have any questions, I would be delighted to answer them.

[The prepared statement follows:]

STATEMENT OF THOMAS D. BELL, JR., EXECUTIVE VICE PRESIDENT, CITIZEN'S CHOICE, INC.

Mr. Chairman and Members of the Committee, I am Thomas D. Bell, Jr., Executive Vice President of Citizen's Choice, a national grassroots taxpayers' organization founded in 1977. Citizen's Choice presently has over 70,000 members nationwide representing all sectors of our society.

I am pleased to have this opportunity to testify before the House Subcommittee on Select Revenue Measures on the topic of reimbursing taxpayers who prevail in tax litigation for reasonable expenses incurred in such litigation. Citizen's Choice is particularly interested in this subject based on the results of a recently-concluded investigation by the Citizen's Choice National Commission on Taxes and the IRS into the relationship between taxpayers and the government. As a result of this study, the Commission made a number of recommendations to Congress, and Citizen's Choice has had the privilege of presenting several of these recommendations in testimony before various Committees of the House and Senate. One recommendation to Congress that came out of this study was that taxpayers who succeed in contesting a tax dispute be reimbursed for attorneys' fees and court costs.

Citizen's Choice established its National Commission on Taxes and the IRS in October of 1979 in response to its members' complaints about tax administration. The Commission was made up of 25 prominent business, academic and professional leaders and was chaired by David McCarthy, Dean and Executive Vice President of the Georgetown University Law Center. The primary aim of the Commission was to explore taxpayer attitudes towards the IRS and its tax administration practices.

To carry out its exhaustive investigation, the Commission solicited the views of over 3,000 taxpayers by holding public hearings around the country, establishing a toll-free "Taxline" and by sifting through hundreds of letters, court documents and transcripts. Over the course of 16 months, members of this Commission and the Citizen's Choice staff held public hearings in ten metropolitan regions across the nation. Thousands of citizens attended these hearings and, along with the staff and commissioners, heard testimony from citizens representing all sectors of our society.

Frankly, the depth of concern, the magnitude of frustration and the level of anger and alienation which we found surprised all of us. It became quickly apparent that

the state of citizen-government relations is not well. The American taxpayer is feeling increasingly alienated and frustrated by the pressures of an ever-increasing tax burden and a tax system which he cannot understand and therefore perceives to be both unfair and frightening. Today's taxpayer feels he has few if any rights in our present tax collection system and an increasing number of otherwise law abiding citizens are beginning to fight back through various tax avoidance gimmicks.

The most disturbing thing we learned was that fear is a deep and pervasive element of taxpayer attitudes towards the tax system and the IRS in particular. A common analogy was made between the taxpayer and the criminal, pointing out that a large, well known body of rights exists for a person accused of a crime, although no similar set of "rights" or guidelines exists for the taxpayer. We found that most taxpayers believe that criminals have a much clearer understanding of their rights under the 1966 "Miranda" warning than taxpayers have in dealing with the Internal Revenue Service.

The Commission found that this fear causes many taxpayers to deliberately pay more tax than they legally owed simply to avoid a traumatic encounter with the IRS. It appeared from the testimony that many IRS agents regard fear and intimidation as legitimate investigative tools. Many taxpayers reported their perception that the IRS acts on a "presumption of guilt"—that an agent regards a taxpayer as guilty of evasion until proved innocent.

A tax attorney with an extensive practice before the IRS put it this way when he testified at our hearing in Tampa:

"Essentially our first contact with the Service is: This person owes the taxes and should pay with whatever they have at the time, or this person has attempted to evade taxes or unlawfully failed to file a tax return. And immediately the burden is shifted to the taxpayer to prove otherwise. And that's a principle that is followed and practiced."

The notion that auditing agents proceed on a presumption of guilt was reflected in the testimony of many witnesses, including a member of Congress and a former IRS agent.

Other suspicions among taxpayers, CPA's and tax attorneys which add to this widespread "fear factor" include a common belief that IRS agents have a monthly or annual quota system. Many also believe that the IRS has sets of secret rules with which to decide particular kinds of cases—rules to which the public is not privy.

As I've mentioned, there are a large number of taxpayers who are so intimidated by their tax system that they in effect purchase their civil rights—and their peace of mind—by paying taxes in excess of what they actually believe they owe, "just to be safe." And, although the United States has one of the highest compliance rates in the world, many citizens are beginning to take the opposite tack. Spurred in part by a perception that the tax system is fundamentally unfair, that tax avoidance is rampant (in other sectors of society) and that the chances of being audited are slim, these taxpayers are joining the so-called "underground economy," or evading taxes in some other manner. The IRS estimate of some $26 billion in lost revenue this year illustrates the magnitude of this problem.

It has become obvious to Citizen's Choice that Congress must act quickly to reassure the taxpayers of their rights and institute long overdue reforms in the tax system if the federal government hopes to regain the confidence and respect of its citizens and taxpayers. We are greatly encouraged to see Congress responding in a timely fashion.

The problems I have described are only symptoms of the real problem, an unmanageable tax code. The only lasting solution to this problem is a sweeping revision of the tax laws to produce a simpler, fairer and more efficient revenue system. Citizen's Choice realizes that this is a long-term solution that will require years of work. However, the frustration felt by taxpayers can be ameliorated to a great extent by more immediate measures.

The Citizen's Choice National Commission on Taxes and the IRS has made a number of specific recommendations both to the Congress and the IRS to ease the present adversary character of taxpayer-government relations. One step which the Congress has already approved is to halt unlegislated tax increases by indexing the income tax schedule. Another step currently under consideration in both chambers of Congress is the enactment of a "Taxpayer Bill of Rights" to make citizens aware of their rights in the tax administration process.

Today we are discussing another necessary part of this tax reform pattern. The enactment of separate legislation to provide for the full reimbursement of costs to those taxpayers who prevail in tax litigation would go a long way toward easing the tension between taxpayer and government. The Equal Acces to Justice Bill, Public Law 96-481, provides a good model for this legislation, but it was not designed to

cover the special characteristics of tax litigation. The writers of PL 96-481 recognized this when they delayed the effective date of that law to October 1, 1981 to allow the taxwriting committees to write a parallel measure for application to tax litigation.

Citizen's Choice urges you to act swiftly in passing such a measure. At the present time many taxpayers, intimidated by the power of the IRS, find it not only easier but much cheaper to concede a dispute and pay. It is the rare taxpayer who wishes to incur the time consuming legal and mental anguish to contest the IRS. Our present system discriminates unfairly against those individuals and small businesses which do not have adequate means to hire the attorneys and accountants necessary to face the IRS in court. Such a measure as we are recommending would put all taxpayers on a more equal footing in our tax administration process. Providing taxpayer reimbursement would also restrain the IRS from indiscriminantly challenging taxpayers in court.

This legislation should be seen, both by legislators and administrators as only part of a larger pattern of tax reform. It should be designed to work together with other measures such as a "Taxpayer Bill of Rights" to educate citizens about their rights and to help them deal effectively with the IRS. We do not believe that this measure will encourage citizens to bypass administrative remedies in favor of litigation if they are fully informed of their rights in the revenue collection process. However, when litigation is a last resort, citizens should not be deterred by lack of financial resources.

It is the responsibility of Congress to guarantee that taxpayer is treated with respect and with the full measure of protection under the law that they are due as American citizens. We therefore urge the members of this Subcommittee to expedite the passage of a bill similar to the Equal Access to Justice Bill to provide for taxpayer reimbursement.

On behalf of the members and staff of Citizen's Choice, I offer to this Subcommittee and to any of its members in particular, our assistance in any way you might find it helpful toward reaching our common goal of a more effective tax administration system.

We look forward to working with you to this end.

Chairman STARK. Well, you raise a couple of questions. If you assume that there are no empirical mistakes, anything we can measure, for instance, where I have the Xerox receipt lying on a table, then, there is not much to argue about?

Mr. BELL. I agree.

Chairman STARK. In a voluntary system, if I am estimating something, I am going to voluntarily estimate in my favor. That is human nature.

None of us likes to pay taxes, so maybe fear is the only way. I am trying to think of another word—"respect" perhaps, to keep us from doing it. The country would be in real trouble if we couldn't continue the voluntary system.

I don't know, maybe I ought to fear. We don't exceed the 55-mile-an-hour speed limit in Maryland, because those guys are there and they are very efficient. I would like to think that where a person has fairly estimated, where they have reported to the best of their ability and just made a mistake in mathematics, they don't have anything to fear or argue about. But where they are trying to go in to the mail-order ministry and create a church or religion, for tax avoidance where in their hearts they really don't intend to operate a legitimate church or religion, I don't know what you do there.

The agent is in a place where he is probably nervous, and if the person thinks they are cheating, they are probably afraid.

My question is, do you think this kind of legislation, as I asked earlier, is going to change the approach of the agents, because they aren't going to pay the fine or the penalty really, or is it just a way to reimburse the person who has innocently had their time and resources wasted?

That is what I think. I really don't think it will have a punishing effect or change the philosophy of collection and enforcement. Maybe you feel differently.

Mr. BELL. I think that it will impact the individual agent, very definitely.

Commissioner Egger stands up here and looks you straight in the eye and says there is no quota system for agents and technically that is probably correct. If you talk with ex-agents, however, there is definitely an informal quota system because each agent knows what is expected of him and what the other agents are doing. If they don't measure up, they won't progress.

Chairman STARK. You don't get promoted by——

Mr. BELL. They are not likely to get very far out on the limb on court cases if the IRS keeps score.

With regard to the fear statement you made, I agree with that; and as long as fear is carefully balanced it is probably an asset. And as we mention in our report, it is hard to imagine another way but fear has now become detrimental to the system.

The poor people feel the rich people get away with murder. The rich people feel the poor don't pay any taxes, and the middle-income taxpayer feels he is getting raped by both ends of the spectrum.

The IRS estimated last year that $26 billion passed through the underground economy and therefore went untaxed. Other private estimates would take it to $100 billion. Our study shows it is definitely going up, not down. For the first time, national studies show it is now considered OK by otherwise honest taxpayers to practice avoiding taxes.

Chairman STARK. You are talking about other than illegal activities?

Mr. BELL. I am talking about even illegal activities.

Chairman STARK. $26 billion; you are talking newspaper dealers, cosmetics-type salesmen.

Mr. BELL. Including the barter system. To say we ought not have taxpayer reimbursement or do any of the other things that would make the system perceived as more fair, and so forth, is ridiculous.

Chairman STARK. Where do you think the burden of proof should rest?

Mr. BELL. On the Government, as it does in any other type of legal action. Presumed innocence is the American way, and to take one specific instance out, which is our tax system, and say here we have presumed guilt and all the other rulings do not apply on tax questions, seems a little absurb and is absolutely unintelligible to the American citizen.

Chairman STARK. Thank you.

Mr. Davis, we have your prepared statement, and if you would like to summarize it, the entire statement will appear in the record in its entirety without objection.

STATEMENT OF EDWIN I. DAVIS, C.P.A., HOUSTON, TEX.

Mr. DAVIS. Thank you, Mr. Chairman, I appreciate the opportunity of appearing before this committee. I have appeared before them in California last year on H.R. 4584, and I have appeared

before the Senate Finance Subcommittee on some of Mr. Baucus' legislation, and hope to appear again concerning attorneys' fees.

I appear as an independent practicing certified public accountant and do not represent any particular profession or advocacy group, just an individual accountant.

I do support strongly the idea of reimbursement of attorneys' fees under certain conditions. I do not believe in making the attorneys' fee bill a license for indeterminate costly litigation against the Government and clogging up the court system.

I was an Internal Revenue agent myself and have practiced taxes for approximately 30 years, and I think I know something about both sides of the fence. Fortunately, we have many good, conscientious Internal Revenue people in our Service. I think the sad part is they have not encouraged enough, their fellow workers, on how to behave themselves and act to keep the public confidence, which is absolutely necessary in our self-assessment system. I believe the attorney's fee bill will go a long way toward restoring confidence in the sorely needed self-assessment system in our country.

Nobody likes to pay taxes, Mr. Chairman, as you said, including myself. I do feel from my clients that although they don't like it, if they feel they have had a fair shake, their day in court, or had somebody courteously consider their case, they will take it because they realize that is the price of living in this country and having your property protected, and if you don't like it, you can go somewhere else.

The particular bills that are pending now in the House, I believe, vary in limitation, some having a $20,000 cap. I believe most of them devote themselves to litigation costs entirely. Now, I have heard various definitions, various suggestions about the reimbursement things, and various testimonies from this subcommittee and others that they think that when the telephone rings and the agent says "I am agent so and so," the costs should start there. I believe absolutely not. The Government has the right—and I do not advocate anything that would impair or impinge or obstruct that right—to justifiably levy, assess, and collect a tax. Maybe when you have a revenue agent's report, you have a controversy locked in. Until that point, you are speculating. But you do not have a controversy locked in until that point.

You pointed out very ably, and the Treasury people did, too, that many cases are settled at the administrative level where they probably should be. There are other cases that are foredoomed to litigation. The Government as a policy matter is precommitted before they even call you about the thing. They have got to litigate, as I believe Mr. Nolan said. They are trying to get a conflict in another circuit to get into the Supreme Court.

I do believe in exhausting reasonable administrative remedies. But if you know in good conscience you are foredoomed to litigation, then I think it is bad judgment to have to waste your time to get there.

As far as your costs are concerned, I do believe—I have worked with distinguished legal counsel in tax litigation—in any complicated tax issue, which all of them mostly are these days, you have to have professional support: Accountants, architects, engineers, doctors, psychiatrists, appraisers, and other people. They have travel

expenses, expenses of preparing the case—not only as expert witnesses but getting there—so I think they should be covered.

The question of the quid pro quo with the Government, well, what is good for the goose is good for the gander, you know. Possibly so. As Mr. Nolan pointed out, though, the Government has the means on this delaying tactic for sheltering your tax in the Tax Court. They have the motion means that they can bring a case to trial, and the commodity straddle, cases which Congress saw fit to amend the law.

The brokerage firm that touted it, offered to pay the tax and attorney's fees and the Government said, "No, we've got 15 more cases"; and the judge said, "I cannot have X brokerage house coming in and settling every case," you are going to try it?

The Government and the taxpayer's expert witness testimony fees alone were $500,000, I am told. I wouldn't advocate anything like that, but it is a little bit steep.

Chairman STARK. I gather that what you are saying—as Mr. Lewis testified a moment or two ago—should a case go all the way through the court, that you should allow the taxpayer the cost of going through each step of the administrative procedure. You are suggesting if it is a three-step process, you ought not to allow the costs until it gets to the second step. In other words, if I am notified that my tax return is going to be audited, the first step is the field audit. I ask my C.P.A. to sit there while they go through the field audit. You are suggesting that ought not be a cost?

Mr. DAVIS. When he writes you an official letter, we hereby propose these adjustments to your taxable income, then you have a controversy locked in there.

Chairman STARK. You are suggesting that is the point at which it ought to start?

Mr. DAVIS. At least not until then, because you are talking academics up to that point.

Chairman STARK. In your testimony you say that you doubt the courts need any other more definitive standards on whether or not the Government has acted unjustly. I might agree with you, but the lawyers we had here today seemed to think it may be necessary to have another phrase.

Do you have any legal concept?

Mr. DAVIS. I am a layman as far as the legal concept is concerned. Somewhere, I think it should be—well, now we have another problem to deal with. It may not be easily disposed of, and that is the question of what do you do if you have an administrative settlement. A court may not have even seen the case, even in the filing.

It has been suggested to me about the arbitration thing. I am told that there is expertise and arbitrators all over this part of the country in every field. It should be a preagreed thing before you go in and say let us agree that they will arbitrate this thing and we will do that when we get through.

In business now, I do agree with the matter of full disclosure.

Chairman STARK. Is that ever done?

Mr. DAVIS. The matter of the full disclosure was brought up this morning. I believe it is a two-way street, because the taxpayer—he should disclose everything he has and not wait until he gets into

court—have the taxpayer show he has exercised good faith and gone into the court and show the court he has disclosed everything. But let the Government have to disclose the same thing to the taxpayers, not hold back some informer's letter that they want to protect the informer from and try to bottom their case on it. It is a two-way deal.

I think also, Mr. Chairman, that each issue should be considered separately, because you can have a conglomerate of issues in a tax matter. They can carry over, back, go to other returns, go to related taxpayers, and I think it should be on an issue-by-issue basis, and I think that is essential.

And another matter—we get to the question of the dollar cap on the legal fees. Well, that is hard to determine. I know this is an unprecedented field in litigation to be awarded fees like this, and I am sure that everything won't please everybody in the initial run on it.

Possibly, if it is a court matter, the court that has heard the case is competent to decide the justifiability of the thing and the amount, and who is entitled to what. If the taxpayer is shown to have acted in bad faith, let him pay up.

We have had, I think, the Justice Department testified 2 years ago that it was almost impossible for them to determine what they had spent on a tax litigation thing. The taxpayer certainly knows what he spent.

We have heard from Treasury several times that—and also Justice Department—the matter of the cost of these things. My answer has been, and my statement has been—and I have not had an answer from them—that if Treasury is not doing something that they have not told Congress and the taxpaying public about, if they are not doing something that they shouldn't be doing, then they have no problem in that area.

Mr. Chairman, in the interest of brevity, let me just conclude, and I will let my written statement speak for itself. I would like to express my appreciation to this distinguished committee for the opportunity of appearing.

I would be glad to answer any questions or be of any assistance to this subcommittee or any other committees and their staffs.

[The prepared statement follows:]

STATEMENT OF EDWIN I. DAVIS, C.P.A., HOUSTON, TEX.

Mr. Chairman and other distinguished members of this subcommittee, I appreciate very much the opportunity of being able to appear before you today as you consider the effects on tax litigation of the Equal Access to Justice Act, P.L. 96-481. I consider it necessary for truly equal access to justice that the government reimburse the litigation costs of taxpayers who are determined to have been unjustifiably subjected to burdensome and expensive litigation in order to prove that their federal tax returns were correct in the first place. I believe there is an increasing need to give our general taxpaying public confidence that they really do have equal access to justice if we are to maintain our self assessment taxation system.

By way of introduction, I am a practicing Certified Public Accountant and have my own accounting practice in the Houston, Texas area where I have dealt with a wide variety of tax matters for approximately 30 years. I do not appear as a representative of any professional or advocacy groups, but merely as an accounting and tax practitioner. Obviously, both I and my clients are interested in the general subject of reimbursement of certain tax controversy costs to taxpayers. I have testified previously at two other similar hearings: on July 19, 1979, before the Subcommittee on Oversight of the Internal Revenue Service of the Committee on Finance of the U.S. Senate, on S. 1444 (introduced by Senator Max Baucus), and on

October 6, 1980, before this Subcommittee in Los Angeles, California, on H.R. 4584 (introduced by former Congressman James Corman). Neither bill reached the floor. However, I believe there is very keen interest in the general subject among a large number of members of both Houses of Congress, and I can assure you that there is widespread interest in the subject among tax practitioners and taxpayers alike.

As I understand the purpose of this hearing, it is to review the potential effects on tax litigation of P.L. 96-481 and the various alternatives to P.L. 96-481 contained in H.R. 1095, H.R. 2555, and H.R. 3262. Most types of litigation with the government, including tax litigation are covered by the cost reimbursement rule contained in P.L. 96-481. In its latter stages the bill that became P.L. 96-481 was amended to delay the effective date of such law as it pertained to tax litigation, to enable Congress to consider and enact measures to deal specifically with tax litigation.

Three bills are now pending in the House to deal with this subject:

1. H.R. 2555 introduced on March 17, 1981, provides that the Court having jurisdiction of the litigation may, in its discretion, award a prevailing party reasonable attorneys' fees and costs. This bill does not expressly provide for reimbursement of costs for other professional assistance (C.P.A.'s, engineers, appraisers, etc.), nor does it provide for reimbursement of costs incurred in administrative proceedings or in matters settled before trial.

2. H.R. 3262 introduced on April 27, 1981, among other things, sets a $20,000 maximum dollar amount on the award. This bill is somewhat more expansive in describing the "prevailing party" entitled to the award, and it does provide that either the court or the parties by agreement could make the decision as to who prevailed. As in H.R. 2555, the bill does not expressly provide for reimbursement of costs for other professional assistance, nor does it provide for any costs incurred in administrative proceedings or matters settled before trial.

3. H.R. 1095 introduced on January 22, 1981, covers all litigation arising from any legal action originally initiated by the government. It specifically also includes any action instituted by a taxpayer contesting the accuracy of a deficiency assessment or claiming a refund of taxes paid. Under this bill the government would reimburse in full the reasonable litigation cost incurred by the taxpayer who prevails or substantially prevails. It is not clear to me whether the reimbursed litigation cost would include costs of other professional assistance where no expert testimony was involved. Further, the bill does not provide for costs incurred in administrative proceedings or for matters settled before trial.

From my experience as a former Internal Revenue Service agent and as a private practitioner, I am certain that there will always be bone fide and honest disagreements between taxpayers and their representatives on the one hand, and the Internal Revenue Service on the other. I am just as certain that in other exceptional cases, taxpayers have been unjustifiably forced to defend administratively, and in our court systems, correct legal positions taken on their tax returns. For taxpayers with limited resources due to inflation and other factors, this can create significant financial problems. For any taxpayer, a decision to resist and possibly end up in litigation requires a decision to pay high costs for professional assistance and to expend a great amount of time preparing for and participating in a trial. I am sure the members of this Subcommittee are aware of situations among their constituents in which a taxpayer has said that he believes he is right—he frankly knows he's right—but because of the high litigation costs and the amount of time demanded to resist, he feels obliged to pay the amount claimed in order to get on with a more productive effort.

At the same time, I do not advocate enactment of legislation that would give the taxpayer a free license and permit to litigate indeterminably. I also do not advocate prohibiting or restraining the Internal Revenue Service in any manner from performing any legitimate duties or examinations of a taxpayer and his records which the law permits. For example, some persons propose to reimburse all costs to a taxpayer from the instant the taxpayer is first contacted by an examiner from the Internal Revenue Service. In my mind this is highly impractical and unfair to the government because the government should not be discouraged from auditing the correctness of tax returns. They must, however, be discouraged from insisting on unreasonable and unfair positions. The interests of the government and the taxpayer must both be balanced.

Upon review of the various alternatives before you, I would like to make several specific recommendations to this Subcommittee:

1. If the taxpayer chooses to litigate, the court that heard the controversy should have the discretion to award costs to a prevailing taxpayer or not, based on its view of whether the government has acted unjustly. I doubt that the courts need any other, more definitive standards.

2. Most tax controversies are settled at the administrative level or prior to trial. To avoid discouraging settlements, it may be appropriate to reimburse administrative appeal costs. also, under appropriate standards. It might be impractical to provide that a court would have jurisdiction to decide the award of costs and fees in a matter not before it. Perhaps the process of arbitration by an arbiter designated under the law or by mutual agreement between the parties could be a solution.

3. In deciding whether a taxpayer is entitled to reimbursement, whether or not the government has acted unjustly should be considered separately for each issue, and reimbursement confined to the cost of contesting the unjust issues. Frequently cases contain many unrelated issues, and the position of the Internal Revenue Service may be meritorious as to some issues and unjustified as to others.

4. The maximum costs to be reimbursed should not be a fixed dollar amount, but should be related to the amount involved, or be a per diem rate, or perhaps be limited to an amount not in excess of what the government expends for its handling of the matter during the existence of proceedings subject to reimbursement.

5. Attorneys handling either administrative or litigation proceedings find it necessary to employ other professionals in the preparation and presentation of their cases. I refer to services of accountants, engineers, doctors, appraisers, and other professionals who may work on the litigation "team" but who are not intended to be expert witnesses. These costs should definitely be covered in the reimbursable costs. Necessary out-of-pocket expenses for travel and the like should also be covered.

There has been in the past, and undoubtedly will be in the future, concern that awarding litigation costs will subject the government to large, indeterminate liabilities. My answer to that is simply that if the Internal Revenue Service conducts itself properly, i.e., if it does not put a taxpayer in a position where he is unjustifiably faced with the alternative of either paying a tax or putting forth considerable financial resources and efforts to defend his position, then there is nothing to worry about. If the government believes large costs could result, then the Internal Revenue Service must be taking too many unjustifiable positions.

In conclusion, I believe the awarding of attorneys' fees and other professional fees and costs, under proper circumstances, to taxpayers is an important matter to be dealt with by this Congress, particularly to restore the confidence of the taxpaying public in the integrity of our tax system and to preserve the self assessment system which has existed for many years.

I appreciate the opportunity of being heard today, and I would certainly welcome any questions or any other opportunity to assist this Subcommittee.

Chairman STARK. Mr. Davis, thank you. You have indulged the chair by allowing me to interrupt as you went along. I appreciate your taking the time to come here and testify on this. It has been very informative.

I would like to call, if I can, to fill the two chairs we have, Mr. James P. Tucker, managing editor of the Spotlight, representing Liberty Lobby, and Mr. Leonard J. Henzke, Jr., counsel for the Shriners Hospitals for Crippled Children.

Mr. Tucker, if you will testify first. And we have your statement, Mr. Tucker. Without objection it will appear in the record in its entirety.

We have Mr. Henzke's statement, which will also appear in the record in its entirety. And, Mr. Tucker, you may proceed in any manner you see fit.

STATEMENT OF JAMES P. TUCKER, MANAGING EDITOR, THE SPOTLIGHT, LIBERTY LOBBY

Mr. TUCKER. Thank you, Mr. Chairman.

I am James P. Tucker, managing editor of the Spotlight, and I do appreciate this opportunity to appear today and present the views of Liberty Lobby's 30,000-member board of policy, as well as approximately 1 million readers of our weekly newspaper, the Spotlight.

If I were schooled in every language on Earth and a past master of all the dead tongues of the ages, words could not express the degree of my commitment to the reform you are now considering.

I appeared 4 years ago before the Ways and Means Committee to tell a horrible story of the Internal Revenue Service's policy of citizen abuse, intimidation and oppression. Mr. Egger was wrong, wrong, wrong in his testimony today. Abuse of citizens is a matter of IRS policy.

During questioning by committee members, I suggested that a taxpayers' bill of rights be adopted which would, among many other reforms, compensate a taxpayer for attorney fees, lost time and incidental costs if he prevails in litigation with IRS.

Within hours after the term "taxpayers' bill of rights" was uttered for the first time, several Congressmen and Senators called asking for suggestions which we were privileged to provide. Related measures are now pending in the House with more than 79 cosponsors.

While Liberty Lobby prefers, of course, to see the complete taxpayers' bill of rights enacted into law, the compensation for legal expenses is an important element and we commend this subcommittee for acting decisively.

This hearing is to discuss what possible effects the Equal Access to Justice Act will have on variations of the law contained in legislation now pending before Congress. The act would award attorneys' fees and other costs to individuals and small businesses who prevail against the Federal Government in civil litigation, including nontax court cases and adversary adjudication proceedings.

Concern has been expressed that the new law will only encourage taxpayers to pursue litigation to get these attorneys' fees and other costs. This concern is certainly no concern for the taxpayer, who needs his rights protected, but for the IRS. The agency has a long history of abusing taxpayers. Often IRS misjudges taxes assessed to taxpayers; its errors result in the taxpayer's paying the amount alleged to be due anyway in spite of his knowledge.

The taxpayer knows that the IRS is wrong, but goes ahead and pays up because he doesn't want to go through the financial and emotional hassle that would result from taking IRS to court. Assuring taxpayers who prevail in their suits that they will receive attorney's fees and other reasonable costs is only just. It would encourage taxpayers to fight back instead of being intimidated by court costs they know they can't afford. And it may discourage the IRS from bullying taxpayers into paying up—no matter what.

If this one aspect of the taxpayers' bill of rights being considered now is enacted into law, it alone will have a chilling effect on the IRS practice of abusing citizens.

Not since the book of Revelation have more prophetic words been uttered than those of Richard E. Byrd—grandfather of my own Senator Harry F. Byrd, Jr. As speaker of the State house of delegates, on March 10, 1910, when the general assembly was debating ratification of the 16th amendment, Mr. Byrd said: "* * * an army of Federal inspectors, spies and detectives will descend on the State." Today, Virginia has yet to ratify the income tax amend-

ment but the Spotlight has published photographs of IRS agents spying on citizens' meetings.

The IRS itself is my source for telling you that they abuse the taxpayers—or, to use their own term, the "scumbags"—that is you and me, gentlemen, you and me—by "infiltration of their organizations" and by "not limiting ourselves to the sanctions in the Revenue Code."

Shocking, true. But it comes straight from secret IRS internal memoranda acquired by and published in the Spotlight [Sept. 13, 1976]. The same memoranda expressly boast of committing a Federal crime, for, in violation of 18 USC 1503, the secret memo says:

> Mr. Howard reported on a change in attitude in federal judges in San Francisco after he met with them and discussed the gravity of the tax rebellion movement and the importance of giving prison sentences as deterrents.

Obviously, gentlemen, such a secret meeting between Federal judges and IRS agents is illegal and immoral; such debate should be confined to open court.

In another secret, internal IRS memo the Spotlight reproduced photographically, the agency boasts of its well-defined policy of harassing small businessmen with frivolous actions: "A proved method of preventing delinquency has been through embarrassment of certain taxpayers."

From there, these monstrous memos boast of closing up the offices of lawyers and doctors and talking local newspapers into embarrassing the victims with publicity that exploits—again, using the IRS terminology—"sensationalism." Again, with reference to the frankly stated IRS policy of litigating frivolously, I quote IRS: "The taxpayer is committed to spend time and money defending his position. Perhaps the inconvenience alone will inspire future compliance."

I can address personally the subject of frivolous litigation. Two weeks after testifying 4 years ago, after receiving anonymous telephone warnings against appearing, I received my first audit notice in my life—for 1975—after filing tax returns for about a quarter of a century. Exactly 1 week before I was scheduled to appear in Tax Court, the IRS called up to surrender and found no deficiency after the agents tried to stick me for $1,400. Of course, there was no compensation for my time or costs. So, in effect, I tasted the ashes of defeat when I should savor victory. Audits for 1976, 1978, and 1979 are all pending, and I am not one bit scared.

With the license now felt by an arrogant gang of bureaucrats who contemptuously scorn the Constitution, the IRS has committed countless atrocities against decent, taxpaying, producing American citizens. For example:

On August 1, 1979, IRS bullies terrorized Mrs. Mona Oliver, of Fairbanks, Alaska, for 7 hours. This morning the Commissioner made some reference to this same case, a little unfortunate incident in Fairbanks. The IRS made a small mistake.

I will leave this—a newspaper photograph—with you, Mr. Chairman, I quote:

> I was bleeding. There was blood all over the place. I had bruises all up and down my legs, and on my arms, too. They almost Maced me. I only saved myself by shouting, "I'm an epileptic."

In 1977, the IRS yanked $707.28 out of the bank account of Bob Martin, Springfield, Mo., for a tax bill that had already been paid.

Rev. Charles Dodge had this experience on March 25, 1977. I quote him:

> While I was counselling in my office of our church with two ladies, three men came to the door . . . They manhandled me and put me in handcuffs, horrifying those who were present.

The IRS had alleged that Mr. Dodge was aiding and abetting the filing of false W-4 forms. They trotted him back three times—a 600-mile trip—without telling him that his kangaroo trial had been delayed, before he was sentenced to 8 years in jail. This, in spite of the fact that every single witness the IRS had, said they filed their forms on their own behalf without contacting Mr. Dodge, who knew nothing about their actions.

If they prevail against the IRS in litigation, do you want them to pay the costs?

Finally, permit me to recall briefly the horror story I told the Ways and Means Committee 4 years ago. William Smiley, Salem, Va., a happy, confident man, was able to cope with the vexations of life and was making systematic payments on a deficiency the IRS claimed.

The last time his daughter, Lela, saw Mr. Smiley was when he arrived home from his job at the railroad about midnight, and as customary in his loving household, visited her room, kissed her goodnight and said something like, "Good night, my little girl." The next day, as usual, she left early for her job as a secretary while her father slept.

The last time Mrs. Smiley saw her husband alive was at lunch, when he complimented her cooking before returning to his front yard, where he sold campers, trailers and such.

The last time Dave Miller, a Roanoke County police detective, saw Mr. Smiley alive was 10 minutes before he died. Detective Miller, by his own account, had dropped by to discuss buying a camper and left his old friend, Mr. Smiley, in a jovial mood. On taking his leave, Detective Miller observed two men approaching Mr. Smiley and assumed they were customers.

His police radio, 10 minutes later, advised that there had been a shooting at the Smiley place. He returned and found Mr. Smiley dead of a gunshot wound. According to the records, Mr. Smiley is supposed to have shot himself in the head, walked to the other end of his office-trailer, placed the pistol behind a wall, returned, and fallen dead in an unlikely position. The bullet was never found. Who could you imagine those two men that approached Mr. Smiley were?

The two men seen with Mr. Smiley during the last 10 minutes of his life were not customers; they were IRS agents Clyde H. Allison and Ralph W. Foster, last known address to me, the Roanoke, Va., office. What occurred between these agents and Mr. Smiley during the last 10 minutes of his life? We will never know because IRS is covering it up. They refuse to allow these agents to be interviewed, even though the surviving Smileys have not only expressly waived their privacy but specifically asked IRS to permit me to interview them. They have persisted in this horrible coverup.

Gentlemen, Congress has created a monster that harasses, intimidates, and bullies the great middle class of producing Americans. Only Congress can kill or tame the monster.

I beg of you, if you have any feeling for the abused workers and wage earners in America, take this one modest step toward controlling this beast.

Thank you again for this opportunity to appear today and present our views.

Chairman STARK. Thank you, Mr. Tucker. I gather that Liberty Lobby supports my legislation.

Mr. TUCKER. Yes, sir, under our license to support the taxpayers' bill of rights.

Chairman STARK. And I also gather from your testimony, which I have enjoyed, that you have spent some time looking into the IRS and the activities of its agents?

Mr. TUCKER. I am a reluctant expert, yes, sir.

Chairman STARK. Have you ever seen any case or cases that IRS or its agents has acted in any way that would be called anti-Semitic?

Mr. TUCKER. No, sir.

Chairman STARK. Good. Thank you very much, Mr. Tucker. I appreciate your testimony.

Mr. TUCKER. Thank you.

Chairman STARK. Mr. Henzke, we have your prepared statement. You may summarize it and it will appear in the record in its entirety, or read it or parts of it as you so desire.

STATEMENT OF LEONARD J. HENZKE, JR., COUNSEL, SHRINERS HOSPITALS FOR CRIPPLED CHILDREN, TAMPA, FLA.

Mr. HENZKE. Mr. Chairman, I will summarize my testimony. I represent the Shriners Hospitals for Crippled Children. My name is Leonard J. Henzke, Jr.

To understand the problems we have, and the reason why I am here, I think I ought to just briefly mention what the Shriners Hospitals is, and what its litigation program is. The Shriners Hospitals for Crippled Children is a tax-exempt charitable organization which operates 21 hospitals in cities across the United States, with a total of about 1,000 beds. The purpose of this charity is to furnish free hospital care to children. The hospitals specialize in treating children with severe burn injuries and with orthopedic problems.

Each of the Shriners hospitals furnishes top-quality medical care to children at absolutely no cost to the parents of the children or to third parties. The hospitals receive no reimbursement, either from any level of government or from health insurance carriers. Last year, the hospitals treated 17,331 orthopedic inpatients and outpatients at an average cost of $4,792 per child and 1,363 inpatients with burns at an average cost of $10,925 per child. The Shriners' Hospitals' operating budget is over $69 million per year, and capital projects in progress are estimated to run over $110 million in the next few years.

All of these capital and operating costs of the Shriners Hospitals are funded completely by contributions from the general public. Indeed, many people who become familiar with the vital work of the Shriners Hospitals choose to donate a substantial portion of

their assets through trust and testamentary charitable contributions. Their gifts are the financial lifeblood of the children's medical care furnished by the hospitals.

The interest of the Shriners Hospitals in legislative proposals relating to attorney's fees reimbursement stems from this total dependence on such charitable contributions. Because of the complexities of the tax laws, trusts, and wills of our donors are occasionally drafted in such a way that the charitable deduction for the gift to the Shriners Hospitals is reduced or disallowed—such as through a disallowance of a charitable deduction for the gift of a charitable remainder—and the increased taxes are borne entirely by the Shriners Hospitals. Indeed, often under such instruments the litigation costs arising from the charitable deduction reduces the cost to the hospital dollar for dollar. For these reasons it is vitally necessary for the Shriners Hospitals to provide legal assistance to the donor's estate in litigation over its charitable contribution deduction.

Of course, many other charities have similar litigation assistance programs respecting the deductibility of their donors' contributions so their interests coincide with ours.

Over the years, rising Federal taxes have eroded the income available to support private charities. At the same time, funds for charity have been further diminished by the fact that donors and charities must pay greater legal fees as a result of the complexities of the charitable contribution deduction laws. In these circumstances, we believe that it is reasonable for the Government to bear at least a part of the financial burden we and all other charities sustain in presenting such tax issues to courts for judicial resolution and interpretation.

Against this background, let me turn for just a moment to our specific proposals for legislation. The provisions of the Equal Access to Justice Act recognize the favored status for charitable organizations. The statute currently allows all charitable organizations which are tax exempt under section 501(c)(3) to obtain the fee reimbursement provided by the statute, without regard to the net worth of the organization. This provision was inserted because otherwise attorney's fees would be a deterrent to charities' vindication of their rights. This is certainly true in the case of the Shriners Hospitals, where their average cost for treating a child can run as high as $11,000, so that each $11,000 spent on attorney's fees to encourage and protect contribution support means the loss of the capability to treat a needy child.

We strongly urge that this legislation be broadened so as to apply to Tax Court litigation. With interest rates in excess of 20 percent, in many instances it is a hardship for the Shriners Hospitals, and estates in which it has an interest through contributions that these estates make, or donors, to pay the tax first in order to get into the district court or the Court of Claims; yet such prepayment is now necessary in cases where the IRS position appears unreasonable and an attorneys' fees award seems likely.

We would also like to propose that the provision making all exempt organizations eligible for fee reimbursements be clarified so as to insure that the Shriners Hospitals will be eligible when it absorbs the costs associated with a controversy between the Inter-

nal Revenue Service and the taxpayer or the estate of a taxpayer respecting a charitable contribution deduction. Both Congress and the Supreme Court have consistently recognized that the deductions for charitable contributions in code sections 170, 642, 2055, and 2522 represent the core of the congressional tax support for such organizations—far more than the tax exemption for such organizaions provided by code section 501(c)(3). The charitable capacity of an organization is equally diminished, whether it spends its funds to litigate the technicalities and complexities of charitable tax law relating to the charity's own tax status, or whether the litigation pertains to the charitable deduction of the donor. Where the charity is funding the litigation respecting the charitable donor, the size of the donor's assets is irrelevant to the adverse impact of the litigation costs on the charity.

To broaden the statute in this way, we suggest that the Equal Access to Justice Act, 5 U.S.C. sec. 504(d)(1)(B), be amended or any substitute statute contain provisions, so as to specifically cover such charity funded tax litigation in cases of charitable contribution deductions, and so as to remove any asset limitation on the charity and the donor taxpayer involved.

Our written statement contains several suggestions for statutory language in this regard.

As a further improvement in the current statute, we propose that language be added which would make clear that the cost of providing witnesses and court reporters incurred in taking depositions in this type of litigation be reimbursable, because that can be a very sizable cost.

Fourth, we also think that the provision requiring the Government to demonstrate that its position is reasonable should be retained. Since the Government's own files will normally contain much of the evidence respecting reasonableness we think that it should have the burden of proof on this issue. Otherwise taxpayers would have to obtain such materials through discovery which would be time consuming and expensive even if the Government did consent to access to its files.

In conclusion, many of you have probably seen recent newspaper reports pointing to studies showing that the new tax law will result in less charitable giving, particularly large donations. Extension of attorney's fees reimbursement legislation as I have outlined here would be one step toward counteracting this trend. It would also be a salutary incentive for tax administrators to focus on situations involving clear and recognized deduction disallowances, and to avoid setting up tax deficiencies on the basis of legal analysis which is hypertechnical or not clearly supported by legislative history or prior judicial decision. I would be happy to answer any questions which you may have, Mr. Chairman.

[The prepared statement follows:]

STATEMENT OF LEONARD J. HENZKE, JR., COUNSEL, SHRINERS HOSPITALS FOR CRIPPLED CHILDREN, TAMPA, FLA.

Mr. Chairman, members of the Subcommittee on Select Revenue Measures. My name is Leonard J. Henzke, Jr., and with me is William J. Lehrfeld. We are tax counsel for the Shriners Hospitals for Crippled Children of Tampa, Florida. We very much appreciate the opportunity that has been afforded us to present the views of the Shriners Hospitals for Crippled Children on the subject of legislative proposals relating to payment of attorneys' fees in tax litigation.

I. Background—the work of the Shriners Hospitals.—The Shriners Hospitals for Crippled Children is a tax exempt charitable organization which was founded in 1922. It operates 21 hospitals in cities across the United States, with a total of about 1000 beds. The purpose of this charity is to furnish free hospital care to children. The hospitals specialize in treating children with severe burn injuries and with orthopedic problems.

Each of the Shriners hospitals furnishes top-quality medical care to children at absolutely no cost to the parents of the children or to third-parties. The hospitals receive no reimbursement, either from any level of government or from health insurance carriers. Last year, the hospitals treated 17,331 orthopedic inpatients and outpatients at an average cost of $4792 per child, and 1363 inpatients with burns at an average cost of $10,925 per child. The Shriners' Hospitals' operating budget is over $69 million per year, and capital projects in progress are estimated to run over $110 million in the next few years.

II. Attorneys' fees reimbursement will substantially benefit the charitable contributions program of Shriners Hospitals.—All of these capital and operating costs of the Shriners Hospitals are funded completely by contributions from the general public. Indeed, many people who become familiar with the vital work of the Shriners Hospitals choose to donate a substantial portion of their assets through trust and testamentary charitable contributions. Their gifts are the financial lifeblood of the children's medical care furnished by the Hospitals.

The interest of the Shriners Hospitals in legislative proposals relating to attorneys' fees reimbursement stems from this total dependence on such charitable contributions. With the enactment of the Tax Reform Act of 1969, the federal tax laws relating to the deductibility of charitable contributions became exceedingly complex, involving matters such as charitable remainder annuity trusts, unitrusts, pooled income funds and other related gifts of partial interests in property. Because of the law's complexity, trusts and wills of our donors are occasionally drafted in such a way that the charitable deduction for the gift to Shriners Hospitals is reduced or disallowed—such as through a disallowance of a charitable deduction for the gift of a charitable remainder—and the increased estate taxes are borne entirely by the Shriners Hospitals. Indeed, often under such instruments the litigation costs arising from the charitable deduction reduces the gift to the hospitals dollar for dollar. For these reasons, it is vitally necessary for the Shriners Hospitals to provide legal assistance to the donor's estate in litigation over its charitable contribution deduction.

Moreover, our litigation assistance, at no cost to the charitable remainder trust, inevitably encourages further contributions; it also gives the Shriners Hospitals a measure of control in determining the legal arguments to be made by tax counsel who can specialize in these controversies and who have litigated previously similar issues on behalf of the charity. Since a technical tax issue in litigation will frequently affect many current or potential charitable donors, it is very important to the Shriners Hospitals that its lawyers have input into the tax litigation. In some instances, for example, such litigation may involve the initial judicial interpretation, or the constitutionality, of tax legislation which is vital to the entire deferred giving program of the Shriners Hospitals. See, e.g., *First Nat. Bank of Oreg* v. *United States*, 571 F. 2d 21 (Ct. Cl. 1978). Indeed, in some tax cases involving the charitable estate tax deduction it has litigated the same issue across the country seeking the most favorable forum. See, and compare, *Merchants National Bank* v. *United States*, 583 F. 2d 19 (1st Cir. 1978) with *Shriners Hospitals for Crippled Children* v. *United States*, 602 F. 2d 302 (Ct. Cl. 1979). See also, *Wells Fargo Bank, N.A.* v. *United States*, — F. Supp. —, 44 AFTR 2d 79-6195, 1979-2 USTC ¶ 13,317 (N.D. Cal. 1979). Of course, many other charities have similar legal assistance programs respecting the deductibility of their donors' contributions, so their interests coincide with ours.

III. Charities' need for attorneys' fees reimbursement legislation is growing more acute.—In providing quality medical care to children without cost, the Shriners Hospitals is performing a quasi-Governmental activity. Long ago the Ways and Means Committee recognized that the allowance of charitable contribution tax deductions was justified by the governmental work done by charities (H.R. Rep. No. 1820, 75th Cong., 3d Sess. 19 (1939)):

"The exemption from taxation of money and property devoted to charitable and other purposes is based upon the theory that the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare."

Over the years since that statement, rising federal taxes have eroded the income available to support private charities, and it has become more essential that donors

be able to provide support with before-tax dollars. At the same time, funds available for charity have been further diminished by the fact that donors and charities must pay greater legal fees as a result of the complexities of the charitable contribution deduction laws. Moreover, skyrocketing medical costs are putting increasingly greater demands on our hospitals. In these circumstances, it is reasonable for the Government to bear at least part of the financial burden we and all other charities sustain in presenting such tax issues to courts for judicial interpretation and resolution.

IV. Specific proposals.—1. The provisions of the Equal Access to Justice Act recognize this favored status for charitable organizations. As you know, the Act currently allows all charitable organizations which are tax exempt under Section 501(c)(3) of the Internal Revenue Code to obtain the fee reimbursement provided by the statute, without regard to the net worth of the organization. This provision was inserted because otherwise attorneys' fees would be a deterrent to charities' vindication of their rights. H.R. Rep. No. 96-1418, 96th Cong. 2d Sess. 15 (1980). This is certainly true in the case of the Shriners Hospitals, where their average cost for treating a child can run as high as $11,000, so that each $11,000 spent on attorneys' fees to encourage and protect contribution support means the loss of the capability to treat a needy child.

We strongly urge that this legislation be broadened so as to apply to Tax Court litigation. With interest rates in excess of 20 percent, in many instances it is a hardship for the Shriners Hospitals and estates in which it has an interest, or donors, to pay the tax first in order to get into the District Court or the Court of Claims; yet such prepayment is now necessary in cases where the IRS position appears unreasonable and an attorneys' fees award seems likely.

2. We would also like to propose that the provision making all exempt organizations eligible for fee reimbursements be clarified so as to ensure that the Shriners Hospitals will be eligible when it absorbs the costs associated with a controversy between the Internal Revenue Service and the taxpayer or the estate of a taxpayer respecting a charitable contribution deduction. Both Congress and the Supreme Court[1] have consistently recognized that the deductions for charitable contributions in Code Sections 170, 642, 2055, and 2522 represent the core of the Congressional tax support for such organizations—far more than the tax exemption for such organizations provided by Code Section 501(c)(3). The charitable capacity of an organization is equally diminished, whether it spends its funds to litigate the technicalities and complexities of charitable tax law relating to the charity's tax status, or whether the litigation pertains to the charitable deduction of the donor. Where the charity is funding the litigation respecting the charitable donor, the size of the donor's assets is irrelevant to the adverse impact of the litigation costs on the charity. And the charity must also concern itself with the "ripple" effect of adverse IRS actions or court decisions.

To broaden the statute in this way, we suggest that the Equal Access to Justice Act, 5 U.S.C. § 504(d)(1)(B), be amended so as to explicitly cover such charity-funded tax litigation, and so as to remove any asset limitation on the charity and donor taxpayer involved. The amended statute would read as follows:[2]

"(B) 'party' means (i) an individual whose net worth did not exceed $1,000,000 at the time the civil action was filed, (ii) a sole owner of an unincorporated business, or a partnership, corporation, association, or organization whose net worth did not exceed $5,000,000 at the time the civil action was filed, except that an organization described in section 501(c)(3) of the Internal Revenue Code of 1954 (26 U.S.C. 501(c)(3)) exempt from taxation under section 501(a) of the Code [may be] *shall be treated as an eligible party regardless of the net worth of such organization, and whether or not it is funding litigation respecting its own tax liabilities or litigation respecting the deductibility to a taxpayer of charitable contributions donated to the section 501(c)(3) organization, and except further* that a cooperative association as defined in section 15(a) of the Agricultural Marketing Act (12 U.S.C. 1141j(a)), may be [a] an eligible party regardless of the net worth of such [organization or] cooperative association, or (iii) a sole owner of an unincorporated business, or a partnership, corporation, association, or organization, having not more than 500 employees at the

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[1] In *Bob Jones University* v. *Simon*, 416, U.S. 725 (1974) and *Alexander* v. *"American United" Inc.*, 416 U.S. 752 (1974), the Supreme Court recognized that most charities depend on the tax deductibility of contributions for their financial well-being, and indeed in many cases for their very existence. Congress has recognized this same fact in enacting Section 7428 of the Internal Revenue Code, which permits a charity to obtain an expedited declaratory judgment as to its deductibility to receive tax deductible contributions.

[2] For purposes of this amendment, "taxpayer" has the same meaning as that in Section 7430(a)(14) of the Internal Revenue Code.

time the civil action was filed; and * * * [Omitted language in brackets, added language italicized]

Of course, we would urge that such language also be made applicable to Tax Court actions.

3. We note that none of the bills which have been introduced and which deal specifically with attorneys' fees reimbursement in tax cases—H.R. 1095, H.R. 2555, H.R. 3262, and S. 752—include any restriction on the size of the eligible taxpayer. We have no position on such an across-the-board omission, but simply urge that if size eligibility limitations are provided, an exception along the lines set forth above be added. Should no size limitation be included, however, we suggest that a sentence be included in the bill making clear that an eligible "party" includes an exempt 501(c)(3) organization which funds the litigation costs of a charitable donor respecting the tax treatment of the taxpayer's donation.

4. The Equal Access to Justice Act, together with H.R. 3262 and S. 752, allow reimbursement of fees of attorneys, reasonable expenses of expert witnesses, and the reasonable cost of any necessary study, analysis, engineering report, test or project. In the case of most charitable tax litigation, however, a major expense is that for witness fees and court reporter fees incurred in taking depositions. We urge that language be added to the Equal Access to Justice Act, and any other fee reimbursement statute, which would make clear that the cost of providing witnesses and court reporters incurred in taking depositions be reimbursable.

5. H.R. 3262 (together with S. 752) would shift to the taxpayer the burden of proving that the position of the United States was "unreasonable." Under the Equal Access to Justice Act as written today, that burden is on the Government. Since the Government's own files will normally contain much of the evidence respecting reasonableness, we think it should have the burden of proof. Otherwise, taxpayers would have to obtain such materials through discovery, which would be time-consuming and expensive, even if the Government consents to access to its files. The burden of proof issue should be dealt with specifically in any legislation which is drafted so that the Government must justify the reasonableness of its actions.

6. The legislative history of any fee reimbursement statute should make clear that attorneys' fees for work done in obtaining an attorney fee award should be included in the same award or a separate award. See, e.g., *Perkins* v. *Standard Oil of California,* 474 F.2d 549 (9th Cir. 1973).

V. Conclusion.—Many of you have probably seen recent newspaper reports pointing to studies showing that the new tax law will result in less charitable giving—particularly large donations.[3] Extension of attorneys' fees reimbursement legislation as outlined above would be one step toward counteracting this trend. It would also be a salutary incentive for tax administrators to focus on situations involving clear and recognized deduction disallowances, and avoid setting up tax deficiencies on the basis of legal analysis which is superfluous, hypertechnical or not clearly supported by legislative history or prior judicial decision.

Chairman STARK. Thank you.

It had really never occurred to me but I can certainly understand that there are a lot of cases where eleemosynary institutions such as the one you represent would have a strong interest in this and that it is expensive.

If I can just digress for a minute. In many cases—and you might check this—wouldn't your patients be eligible for supplemental security income and thereby medicaid, particularly if they were from very poor families and were poor themselves?

Mr. HENZKE. They are eligible, no question. Many of them are eligible for Blue Cross, Blue Shield, or other reimbursement. But Shriners Hospitals have been in existence for many years, and from the very beginning it was their policy not to receive any reimbursement from any third party. They feel that this policy gives them the necessary independence so that they can provide absolutely top quality care. They don't want to take third-party reimbursement from the Government. They want to maintain complete control.

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[3] See "The Federal Government and the Nonprofit Sector: The Impact of the 1981 Act on Individual Charitable Giving," a study for Independent Sector by Charles T. Clotfelter and Lester M. Salamon, published by Urban Institute (August, 1981).

Chairman STARK. I, too, am a highly principled individual, but my first principle has always been flexibility. I am thinking of children for whom SSI was designed where they are disabled, and I can't imagine that anybody on any principle would not permit the Government to pay for their medical care or some of it at least through medicaid and give them some limited income.

Mr. HENZKE. Mr. Chairman, if I might, these areas, these burn and orthopedic areas, tend to be areas where a great deal of research is done by the Shriners Hospitals, and I think it is their feeling that not accepting the third-party reimbursement allows them total and complete control and flexibility, and I know that as a result of their control and flexibility, for example, they have made great advances in the use of artificial skin in their burn centers, and indeed their orthopedic and burn centers——

Chairman STARK. I acknowledge the good works. It just occurred to me that they might be passing up some dollars that might be all too scarce. The point is interesting. I can just summarize by saying certainly I would hope that if this legislation passes in whatever form, that it would make the job of collecting your share of whatever you are entitled to from various estates simpler and less costly, and I appreciate you taking the time to be here and testify.

Thank you very much.

Mr. HENZKE. Thank you for your time, Mr. Chairman.

Chairman STARK. That concludes the testimony. The official record of the committee will be held open until Thursday.

The subcommittee is adjourned, subject to the call of the Chair.

[Whereupon, at 12:45 p.m., the hearing was adjourned.]

[The following was submitted for the record:]

STATEMENT OF HON. PHILIP M. CRANE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. Chairman; thank you for the opportunity to be able to testify on legislative proposals relating to payment of attorneys' fees in tax litigation.

Bureaucratic encumberance is no justification for the taking of property without due process of law. The testimony your committee is about to receive today is crucial, for it will help Congress determine whether additional due process needs to be afforded to taxpayers when involved in disputes with the federal government over tax matters.

Much has been said of the concern for government, of concern for administrative convenience in the discussion of whether or not a successful defendant in a tax case ought to receive attorneys' fees in the defense of his proven innocence. The question which to me seems a great deal more appropriate and necessary, however, is what about the injustice, violation and unfounded loss of property to innocent free men, who for no provable reason had the rights to their property challenged and at great financial cost. This is a question of more paramount interest and one which the government is bound by the Constitution to answer in favor of the defendant regardless of the administrative snarl it might cause.

It has been reasoned that allowing defendants to litigate for attorneys' fees might decrease the number of out of court settlements for it will produce a financial incentive for the defendant to continue his defense. It appears as though the governors are concerned that defendants may actually be inclined to pursue justice now until it is fully and fairly obtained. It occurs to me as well the flaw in this reasoning is apparent on its face. Constitutional rights supersede administrative conveniences.

The government must come to realize that their concern over the flood gates of litigation being opened is no justification for the unlawful taking of property. The reason that settlement rates are so high is more than likely due to the fact that the burden of defense against the weight of the federal government is so onerous that free men are unable to bear it whether or not they are innocent. Should this prove to be the case, this is all the more reason why attorneys' fees ought to be allowed and no reason for their denial.

If administration of increased due process does prove to be a burden, other solutions need to be pursued than the neglect of a defendant's Constitutional rights. It may be the government will simply have to be more judicious in the challenges they make and the claims they bring so as to limit litigation. If their case is more clear cut from the outset less dispute will occur over the outcome. This in my mind is a more favorable direction and one which should be more fully pursued today and hereafter.

Thank you, Mr. Chairman.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS,
Washington, D.C., October 13, 1981.

MS. JAYNE BOYLE,
Professional Staff Member, Subcommittee on Select Revenue Measures, Committee on Ways and Means, Washington, D.C.

DEAR JAYNE: I want to thank you once again for affording NFIB the opportunity to submit testimony to your Subcommittee concerning Equal Access in Tax Court cases.

Unfortunately, due to a myriad of personal and professional complications, I have been unable to comply with your timetable. Nonetheless, I am enclosing NFIB's written submission in the vague hope that perhaps our testimony could be added as an appendix to the subcommittee's proceedings and be utilized at a later date.

Again, I thank you for your courtesy and patience which may very well have been in vain. Please be assured that you can call on us at any time as this or other legislation impacting on small business progresses through your subcommittee.

Looking forward to working with you in the future, I am

Sincerely,

GREGORY E. MCGOWAN,
Legislative Counsel.

STATEMENT OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS

Mr. Chairman, NFIB on behalf of over 500,000 small and independent business members appreciates the opportunity to comment on your bill, H.R. 3262, along with others providing for the awarding of court costs and certain fees to prevailing parties in civil tax actions.

We congratulate the Subcommittee for "going the final mile" by attempting to provide a prevailing taxpayer suitable recompense for fees incurred in the successful defense of a government action in the Tax Court. Reimbursement of court costs and attorneys' fees was one of the top fifteen recommendations of the last White House Conference on Small Business.[1] Moreover, NFIB members supported this proposal by a large Mandate margin, 85 percent to 11 percent.

As you are aware, NFIB vigorously endorsed and worked for the enactment of the 1980 Equal Access to Justice Act (P.L. 96-481). Unfortunately, certain technical oversights by the Congress at the time of this Act's passage have resulted in deficiencies which the NFIB respectfully requests that this Congress rectify at the earliest possible time.

NFIB strongly believes that the Tax Court, as well as the U.S. District Courts and Court of Claims, should be authorized to award reasonable fees for IRS-approved practitioners (as defended in IRS Circular 230) as well as expenses for a taxpayer who prevails in a civil tax proceeding. This proposal would treat the Tax Court by the same standards as the District Court and Court of Claims for purposes of awarding practitioner fees in tax litigation.

NFIB feels that there is no reasonable justification for treating taxpayers differently depending upon the forum in which the tax dispute is heard. This is especially true since the Tax Court is the only forum in which taxpayers may litigate their tax disputes with the Internal Revenue Service without first having to pay the tax which the Service alleges to be due. For NFIB members with limited resources due to inflation, high interest rates and other significant financial problems, the Tax Court is the overwhelmingly preferred forum choice of small businesses. By not extending equal access to the Tax Court, congress would be denying relief to those

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[1] Delegates to the White House Conference on Small Business, in January 1980, debated and voted upon several recommendations for small business policy. Among the top fifteen policy recommendations was an endorsement of the principle of Equal Access legislation.

"Small business should be eligible for magistrate review of agency civil penalties, and reimbursed for court costs, reasonable attorneys' fees, and damages from administrative action, if successful in civil disputes with Federal government, including IRS."

very persons which Congress in its wisdom wanted to initially render much-needed relief.

While we are aware of three bills already introduced in the House which address this inequity, it is our feeling that no single bill adequately covers our concerns in this area. First NFIB is aware that most tax controversies are settled at the administrative level or prior to trial. Since justice delayed is not only justice denied but also a tremendous investment of resources for a small business, NFIB does not wish to discourage settlement of cases. For this reason a final version of this legislation should call for the reimbursement of fees and costs of administrative appeals to prevailing taxpayers by the Internal Revenue Service after it has been determined that the administrative appeals process has been exhausted. Failure to do so will encourage some taxpayers to bypass a possibly simple and productive method of resolving their problems in favor of litigation, simply because their costs may be recovered if they prevail in Tax Court. The resulting inundation of Tax Court dockets will result in time-consuming and expensive delay in resolving tax controversies, something our membership can ill afford.

The second question which we feel needs some attention concerns what cases are appropriate for fee awards. NFIB strongly supports legislative language that shifts the burden of proof to the government so that fees and expenses would be rewarded to prevailing taxpayers unless the government can show that its position in a particular case was at least "substantially justified." Any lesser burden of proof would negate the very intent of legislation of this kind, which is to ensure that the vast enforcement power of the federal government be selectively and prudently exercised.

Thirdly, NFIB does not support any cap on the amount of fees and other expenses that could be recovered from the government. There is evidence that small firms frequently do have reason to believe that the government has brought unjust or inflated civil charges against them. For example, the Chief Judge of the United States Tax Court reported that in 1975 the IRS won less than one of every three dollars it charged taxpayers with underpaying.

"In the total number of cases for last year, the amount of deficiencies determined by the IRS was $490,860,178. The amount redetermined by the Tax Court was $145,324,630. That figure comes out to a percentage recovered by the government of 29.6 percent."[2] (See Table)

Since NFIB recognizes the possibility of engendering frivolous suits as a result of this fee provision, we would not oppose any concomitant increase in the damages meted out against taxpayers who institute court proceedings merely for delay or for other unjustified purposes. To this end, since Code Section 6673 presently authorizes the Tax Court to award damages of up to $500 against taxpayers who institute frivolous proceedings, we would urge that the maximum amount of an award under this provision be increased significantly.

NFIB believes that equal access to justice in Tax Court cases more than outweighs by any cost-benefit analysis any arguments to maintain the status quo. We have attempted to offer constructive suggestions as to how to best provide for small business access to the judicial process and restraint of unwarranted government action on the one hand versus timely judicial resolution of pending controversies and proper enforcement of tax laws on the other. While other interests may decry the chilling effect on the enforcement of the Internal Revenue Laws, we at NFIB bear witness every day to the equally chilling effect on productivity and ultimately on lost tax revenues of federal regulatory overkill of small business. To this end, while we at NFIB applaud innovations such as the so-called "small case" procedures under Code Section 7463, we do not share the perhaps exaggerated fear of an ever-expanding backlog of cases in the Tax Court due to the pot of gold of expanded attorneys' fees measures, in the event this legislation passes.

Small businesses have one overriding concern when embroiled in tax controversies like those under discussion, i.e. to vindicate themselves at the lowest possible cost in time, resources and energy. Any possibility of practitioner profiteering at the expenses of the client or the government can be greatly reduced by the IRS formulating a comprehensive, written description of the taxpayers rights and the avenues at his/her disposal to protect them.

NFIB welcomes any comments which this Subcommittee may have with respect to our statement and stands ready to provide you with any pertinent information at our disposal.

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[2] Treasury, Postal Service, and General Government Appropriations for Fiscal Year 1977, Part 4, House of Representatives Committee on Appropriations, (Government Printing Office: Washington, D.C.), 1976, pp. 712–713.

ANALYSIS OF TAX COURT REDETERMINATIONS

Method of closing	Number of dockets	Amount of deficiency determined by IRS	Amount of deficiency redetermined by tax court	Percentage recovered by the Government
Small tax cases:				
Stipulation	1,993	$1,147,930	$528,940	46.1
Opinion	304	189,130	146,590	77.5
Total	2,297	1,337,060	675,530	50.5
Regular cases:				
Stipulation	4,405	429,474,600	119,015,700	27.7
Opinion	655	59,994,510	25,633,400	42.7
Total	5,060	489,469,100	144,649,100	29.6
Total cases:				
Stipulation	6,398	430,622,530	119,544,640	27.8
Opinion	959	60,183,640	25,779,990	42.8
Total	7,357	490,806,170	145,324,630	29.6

Note: Data excludes cases dismissed without determination by the Court.

NATIONAL TAXPAYERS UNION,
Washington, D.C., October 1, 1981.

Hon. FORTNEY H. STARK,
Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the 450,000 family members of the National Taxpayers Union in all 50 states, I am writing to express our views for the hearing record on legislative proposals relating to payment of attorneys' fees in tax litigation. We favor the concept of reimbursement of costs for taxpayers who prevail in tax litigation and support enhancing the Equal Access to Justice Act as it applies to tax cases.

Currently, the taxpayer faces extreme disadvantages when a dispute arises with the Internal Revenue Service (IRS). Compared to the individual taxpayer, the IRS has virtually unlimited resources. If the taxpayer loses the dispute, he loses time, wages, expenses, and can be assessed penalties. If he wins he gets to keep his money minus court costs, time, wages and other expenses incurred. These costs frequently exceed the amount of money the taxpayer is allowed to keep. The result is frustration as taxpayers decide it's cheaper to pay than to battle injustice. This creates an incentive for the IRS to make unfounded claims, knowing that it is often cheaper for the taxpayer to pay than to defend himself.

To correct this injustice, taxpayers who prevail in legal disputes with the IRS should be reimbursed for their full legal costs. These costs should include attorney fees, accounting fees, and the costs of any analysis or study, as well as any direct court costs. By providing for reimbursement of such costs, taxpayers would not be deprived of a real opportunity to defend themselves, and taxpayers would be protected from frivolous IRS claims.

We were heartened by passage of the Equal Access of Justice Act during the 96th Congress. The Equal Access to Justice Act will help reduce the awesome disadvantages taxpayers now face in a dispute with the IRS.

But there are several steps that should be taken to enhance the Equal Access to Justice Act as it applies to tax litigation. The most important is to give the Tax Court authority to award payment of fees to taxpayers who prevail in tax litigation.

We also believe that awards of fees should be mandatory except in narrowly defined circumstances, certainly no broader than those provided for in the Equal Access to Justice Act. Unfortunately, we fear that if it is left to the discretion of the Tax Court, taxpayers may not get the relief they deserve.

A formula approach may be worth placing in legislation. To determine the percentage of fees that should be awarded, one could weigh the claim made by the IRS versus the deficiency assessment, if any, left once the case has been resolved by the Tax Court. For example, if there was a $10,000 claim by the IRS, and after litigation only a $1,000 assessment remained, the taxpayer could be said to have won 90 percent of the case, and would therefore be reimbursed for 90 percent of fees. Such a provision would actually encourage less litigation because it would encourage the IRS not to litigate frivolous claims.

Some commentators have warned that awards of fees may encourage litigation by taxpayers who would circumvent administrative remedies. The best remedy would be to authorize reimbursement of fees and costs incurred during administrative appeals to the IRS. After all, costs incurred at the administrative level can be substantial and can easily exceed the claim made by the IRS. If a large cost barrier remains at the administrative level. the typical taxpayer will still not be able to afford assistance. Another solution although not as desirable, would be to specify that taxpayers should exhaust administrative remedies in order to qualify for fee awards in tax court. Fee awards should cover all reasonable expenses incurred following receipt of the 30 day letter from the IRS.

While we commend you and the sponsors of H.R. 3262 and H.R. 2555 for introducing legislation on this important issue, we do not believe these proposals will effectively solve the problem; both leave relief to the discretion of the court. We are also particularly concerned with the provision in H.R. 3262 requiring the taxpayer prove that the position of the United States was unreasonable. It's hard to see how the taxpayer could possibly prove that the government was unreasonable. The government has the facts in its control as to why it pursued its action. At the very least, the burden should be on the IRS to prove that it was not unreasonable. If the taxpayer wins the case we feel he should be reimbursed for reasonable court costs. If the position of the IRS and the United States is wrong, taxpayers should not have to further prove that the position is unreasonable and then rely on the discretion of the court to reimburse court costs.

H.R. 3262 limits reimbursement of court costs to $20,000. The bill already limits reimbursement of court costs to a reasonable amount. If the costs are reasonable, and over $20,000, there is no fair reason not to reimburse the taxpayer. This provision guarantees tht the IRS regains the inherent advantages over the taxpayer in a case of above average complexity.

In summary we hope that the Committee will move to enhance the Equal Access to Justice Act as it applies to tax litigation.

Sincerely,

DAVID KEATING,
Director of Legislative Policy.

STATEMENT OF JAMES T. O'HARA, WASHINGTON, D.C.

Mr. Chairman and members of the Subcommittee, I am pleased to have the opportunity to present my views on the matter of awards of attorneys' fees to parties who prevail in civil tax litigation. My name is James T. O'Hara and I am a partner in the law firm of Jones, Day, Reavis and Pogue, where I practice in the area of federal taxation. This statement represents my personal views, and is not submitted on behalf of any client. I hope that my suggestions will be of assistance to the Subcommittee in its efforts to seek a fair and workable solution to the subject now before you.

I believe that the opportunity of a successful litigant to recover attorneys' fees, where the opposing party has taken a manifestly unreasonable position, can contribute to the just and expeditious resolution of tax controversies. Our tax collection system is primarily one of self-assessment. Its success rests in part upon taxpayers' expectations that they will be able to obtain effective redress when they disagree with government determinations. The increasing complexity of the economy, and hence of the tax laws, has generally rendered the assistance of counsel indispensable to persons involved in tax disputes. The opportunity to recover attorneys' fees when the government has taken an unwarranted position will demonstrate that a taxpayer, even of limited means, can expect an equitable resolution of a tax controversy. For these reasons, I support adoption of legislation extending those provisions of the Equal Access to Justice Act, 28 U.S.C.A. §2412 (Supp. 1981), which permit courts to award attorneys' fees in tax litigation.

Moreover, I share the view of the American Bar Association that legislation allowing recovery of attorneys' fees in appropiate instances should apply to cases in the Tax Court as well as in other federal courts. The Tax Court is often the forum which is most accessible to taxpayers with relatively modest claims, who likely are the taxpayers whom the Congress will most desire to assist by enacting attorneys' fee legislation.

While recognizing the merits of attorneys' fee legislation, however, I also believe that allowing awards of attorneys' fees in tax cases will require the resolution of some practical problems. The prospect of recovering attorneys' fees may encourage taxpayers to pursue nonmeritorious claims, thereby placing increased strain on an already overburdened court system. In addition, if the standards for recovering

attorneys' fees are not made sufficiently selective, the costs of allowing the recovery of fees may become prohibitive.

I believe that by incorporating several additional features in its legislation, Congress can substantially enhance the prospects for success of a law allowing recovery of attorneys' fees in tax litigation. Most importantly, Congress should provide that the government, as well as the taxpayer, can recover attorneys' fees in appropriate cases. By making the law reciprocal in this manner, Congress can discourage spurious claims, and thereby conserve judicial resources for more serious controversies. In addition, Congress should make clear in its legislative history that the courts should apply a relatively strict standard in determining when a party's litigation position has been sufficiently unwarranted to justify an award of attorneys' fees. Congress can thereby control the prospective costs of attorneys' fees legislation without creating a disincentive to parties having meritorious claims who might fear being assessed for the government's fees. The following discussion will address the questions of reciprocity and standards for recovery, and will offer recommendations which I hope will assist the Congress in enacting successful legislation.

I. RECIPROCITY

While a primary purpose of attorneys' fee legislation is to enhance taxpayers' confidence that they will not be subject to unfair government claims, not all unreasonable positions in tax litigation are advanced by the government. In a number of cases, for example, in defense of flagrant attempts at tax avoidance, taxpayers have taken positions which have been obviously unwarranted under applicable Code provisions. In other cases, in attempts to register political protests, taxpayers have instituted suits on manifestly spurious grounds. The government, and therefore the American taxpayer, has borne the expense of litigating these claims. It will be more appropriate for the taxpayer who has burdened the judicial system with the spurious claim to bear the costs of the litigation.

Allowing the government to recover attorneys' fees in appropriate cases should not inhibit taxpayers from raising bona fide claims, so long as the standards for allowing recovery of fees are sufficiently selective. Indeed, by allowing the government to recover attorneys' fees in appropriate cases and thereby discouraging taxpayers from filing baseless claims, Congress will lower the net cost of attorneys' fee legislation, and will make resources available to allow more expeditious resolution of genuine controversies.

II. THE NECESSITY OF ESTABLISHING STRICT STANDARDS FOR RECOVERY

By requiring a litigant to make a relatively strong showing in order to recover attorneys' fees, Congress will substantially enhance the effectiveness of legislation allowing recovery. A low standard for recovery of attorneys' fees would likely discourage settling tax disputes prior to litigation thereby leading to increased burdens on the court system. In addition, if the standard for recovery of attorneys' fees is set too low, a taxpayer might, for example, refrain from pursuing a meritorious claim for fear that an adverse judgement might be compounded by an assessment for the attorneys' fees of the government. The Treasury might also be reluctant to press reasonable claims in certain cases, thereby causing the government to drop legitimate tax disputes. In each of these cases, the proposed legislation would not be fulfilling its purpose.

Congress can establish a workable standard by providing that a party may recover attorneys' fees where the opposing party has taken a "manifestly unreasonable" position. The use of the phrase "manifestly unreasonable" would establish that an award of attorneys' fees would be appropriate where case precedent and other authorities should have made it clear to a litigant at the outset of litigation that there was no reasonable possibility of prevailing on the merits. The term would not apply to situations where an unsuccessful party made a good-faith, well-reasoned argument for a change in an unsettled area of law.

Congress can enhance its legislation by incorporating in the legislative history a non-exclusive list of examples of what may constitute a "manifestly unreasonable" position. This list can provide guidance to courts, and can assist the Internal Revenue Service in drafting regulations pertaining to the legislation. The following list of situations where a fee award would be warranted is adapted from the Statement to the Subcommittee of Mr. John S. Nolan of the American Bar Association, and is amended to reflect the view that legislation allowing recovery of attorneys' fees should be reciprocal. A party would take a manifestly unreasonable position where:

(1) A reasonable investigation of the facts would have clearly demonstrated to a party that its position probably would not prevail.

(2) Existing law and precedent is so firmly established that a reasonable person would realize that a contrary contention probably would not prevail.

(3) The government's position is contrary to a published position of longstanding administrative practice or its published acquiescence in a Tax Court decision, on which a taxpayer justifiably relied in structuring a transaction or activity.

(4) The government has taken a position with respect to a taxpayer, which is contrary to the position which it has taken in a private ruling issued to that taxpayer, and the taxpayer's situation conforms to the facts which it clearly set forth in its request for a ruling.

(5) The facts and circumstances of the case demonstrate that the government has attempted, by proceeding against a taxpayer, to extract taxpayer concessions on the litigated issue or other issues which were clearly not justified by the facts of the case.

(6) The party seeking recovery refused to negotiate in good faith with the other party in attempting to settle the case at a prelitigation stage.

This list is not, of course, exhaustive. Moreover, it is couched partially in general terms, so as to encourage courts to exercise latitude in applying the standards to the necessarily unique facts of a particular case. Nevertheless, by providing a list of this nature, Congress can offer workable guidelines to the courts and place both the government and the taxpayers on notice of the potential cost of abusing the judicial process.

III. OTHER SIGNIFICANT ISSUES RAISED BY THE LEGISLATIVE PROPOSALS

Closely related to the question of what standard to apply in awarding attorneys' fees is the question of who shall bear the burden of proof in establishing that an award of fees is or is not warranted. In its statement, the American Bar Association has pointed out that many of the documents upon which a litigant might base a claim for recovery of attorneys' fees will be in the hands of the opposing party, and to require the party seeking recovery of fees to bear the burden of proof will require costly discovery. On the other hand, requiring the party seeking recovery to bear the burden of proof is a useful mechanism for ensuring that attorneys' fees are awarded only in the most deserving circumstances. These considerations can be resolved by providing that the party seeking recovery of attorneys' fees must make an initial showing that a recovery of attorneys' fees is warranted, but that the burden of proof will shift after the party seeking recovery has made a prima facie showing. This compromise would require the person seeking recovery to set forth affirmative legal arguments to justify an award of fees. In addition, it would place the burden of producing documents upon the party which can bear this burden most efficiently.

Prior discussions of legislation to allow recovery of attorneys' fees have considered the question of whether a party's recovery of fees should be limited to a predetermined, maximum amount (for example, $20,000 in H.R. 3262), or whether recovery should be limited to taxpayers of less than a certain net worth, as in the Equal Access to Justice Act, which sets a $1,000,000 limitation for individuals and a $5,000,000 limitation for certain classes of business organizations. I believe that in the period immediately subsequent to the enactment of attorneys' fee legislation, the $20,000 limitation of H.R. 3262 is a reasonable ceiling. In principle, an arbitrary limitation on the amount of attorneys' fees which a party may recover is inappropriate. Tax litigation varies greatly, with respect both to the amounts in controversy and to the complexity of the issues involved. A limitation which appears reasonable in the abstract may not be appropriate in a particular case. Nevertheless, for several years following the enactment of legislation, the award of attorneys' fees in tax litigation will remain experimental in nature. Therefore, for a limited period of time, a ceiling on the amount of recoverable fees may be desirable. I hope that after the courts have had sufficient experience on this subject, Congress will reassess the need for a limitation of the maximum amount of recoverable fees.

A limitation of the amount of recoverable fees is strongly preferable to a limitation based upon the net worth of a party who may claim recovery fees. As the American Bar Association has pointed out, a taxpayer with a very large net worth may nevertheless be deterred from asserting a meritorious position where the amount of tax involved is not large in relation to the legal fees which the taxpayer would have to bear in litigation. Moreover, the determination of net worth in a particular case would pose substantial factual issues. Therefore, I share the position of the American Bar Association that a limitation based upon taxpayer net worth would pose unnecessary costs to the judicial system.

Prior discussions have considered whether to allow recovery of costs incurred at the prelitigation, administrative stage of a tax controversy. I believe that allowing recovery of fees during administrative proceedings would detract from the effectiveness of legislation allowing recovery of attorneys' fees. Administrative proceedings prior to litigation often take on the character of negotiations, which may be very informal in nature. The threat of an assessment for attorneys' fees for taking an "unreasonable" position during these proceedings might unduly inhibit both sides from engaging in the type of freely-moving discussions which might lead to a settlement. Moreover, a party seeking reimbursement of fees incurred at the administrative stage would be required to apply to a court for a reimbursement. This would require judicial inquiry into the facts of the parties' conduct during the administrative proceedings, and would therefore present demands on judicial resources.

Nevertheless, although I recognize the practical difficulties inherent in allowing recovery of attorneys' fees incurred during the administrative stages of a controversy, I agree with both the Treasury Department and the American Bar Association that legislation allowing recovery of attorneys' fees should encourage the prelitigation settlement of tax controversies. Otherwise,. the allowance of attorneys' fees will encourage litigants to forego opportunities to settle controversies administratively, where the litigants believe that they stand a good chance of recovering attorneys' fees following a trial. Therefore, the above list of examples of circumstances justifying fee awards includes a provision that a party should be permitted to defend against an assessment for attorneys' fees by showing that the opposing party did not cooperate in efforts to obtain a settlement prior to litigation.

V. CONCLUSION

In sum, legislation allowing recovery of attorneys' fees can substantially contribute to the goals of fair and efficient resolutions of tax disputes. Moreover, Congress can enhance the effectiveness of attorneys' fee legislation by providing that both taxpayers and the government can seek recovery on a reciprocal basis, and by ensuring that the law incorporates reasonably strict standards for recovery. In the foregoing statement, I have set forth suggestions which I hope will assist the Subcommittee in drafting proposed legislation. I will be very pleased to provide any further assistance which the Subcommittee may desire.

Statement of Chief Judge Theodore Tannenwald, Jr.,
United States Tax Court,
on Legislative Proposals Relating to Payment of
Attorneys' Fees in Tax Litigation

Before the Subcommittee on Select
Revenue Measures,
Committee on Ways and Means,
U.S. House of Representatives
September 28, 1981

This statement is submitted in lieu of a personal appearance, on behalf of the United States Tax Court, with respect to various legislative proposals contained in House of Representatives bills relating to the payment of attorneys' fees and costs in tax litigation. Because each of these proposals, if enacted, would have an enormous impact upon the effective functioning of the Tax Court, I believe it important to bring the views of the Court to the attention of the Congress, and I would be pleased, should the Subcommittee so desire, to appear and answer questions regarding the proposed legislation.

Before I set forth the views of the Court, one preliminary observation is in order: I know that there is

a question as to the applicability of the Equal Access to Justice Act, Pub. L. 96-481, to Tax Court litigation. Obviously, the need for, and character of, further legislation will depend upon how this question is answered. However, since this question may well be presented to the Tax Court for decision, I think it would be inappropriate for me to make any comments thereon. Rather, I think the views of the Court should be directed toward exploring the problems as if the question of awarding attorneys' fees and costs in litigation before the Tax Court was being considered de novo.

I. Should Attorneys' Fees and Costs of Litigation be Awarded by the Tax Court?

A. General

Whether the Congress should create a right to an award of attorneys' fees and costs in tax litigation is a matter involving competing considerations. Vigorous enforcement of the tax laws by the Internal Revenue Service and the Department of Justice is generally perceived as essential, not only to insure that the Federal Government collects the revenue necessary for it to function effectively, but also to discourage less conscientious taxpayers from attempting to shift part of their tax burden to others. In fact, the Congress long ago recognized the importance of the collection of the revenue by providing that, with certain limited

exceptions, no suits can be maintained to restrain the assessment or collection of any Federal tax. See section 7421, I.R.C. 1954. On the other hand, the taxpayer's right to fair and evenhanded treatment cannot and should not be denied. I am sure that everyone recognizes that these competing considerations must be carefully balanced in reaching any decision, but, as the Subcommittee's announcement of this hearing indicated, there are enormous difficulties in achieving the proper balance. Where litigation in the Tax Court is concerned, there are several extremely significant considerations which should be taken into account:

(1) The unusually large volume of litigation before the Tax Court now pending and in prospect.

(2) The fact that a very large percentage of the cases litigated before the Tax Court are settled.

(3) The presence of a small tax case procedure in the Tax Court, which Congress has constantly shown its desire to encourage and where taxpayers have been able to present their cases informally, promptly, and in person without any need for legal representation.

(4) The fact that most cases in the Tax Court, unlike other types of litigation and tax litigation in the district courts and the Court of Claims, involve a multiplicity of issues, so that the determination of entitlement to attorneys' fees and costs of litigation becomes a much more complicated

question.

(5) The increasing number of cases being brought to the Tax Court by so-called tax protestors who have sought, and continue to seek, to invalidate the application of the Internal Revenue Code to them on a variety of constitutional and other grounds which have repeatedly been determined to be without merit.

(6) Closely allied to the tax protestors are the taxpayers who simply refuse to deal with the Internal Revenue Service at any time -- whether during an attempted audit or in the preparation of a case for trial after they have filed their petitions in the Tax Court. They finally produce their records when their case is called for trial and, in effect, want the Tax Court to be the auditor. The number of taxpayers in this category has increased significantly in recent times.

It is against the background of the foregoing considerations that the Congress must reach a decision. There is no doubt that there are situations where the Internal Revenue Service has been overreaching in its audit procedures. But these situations appear to represent a very small part of the picture. When they are evaluated in the context of the considerations which I have previously set forth, serious doubts arise as to to whether legislation awarding attorneys' fees and costs of litigation to taxpayers

is an appropriate solution. The ultimate decision, of course, is the prerogative of the Congress. In any event, if it is determined that the award of attorneys' fees and costs of litigation to taxpayers is an appropriate method of dealing with the situation, the legislation should be as simple as possible in order to minimize the potential for adding further litigation to an existing overly heavy caseload and should contain provisions authorizing the imposition of countervailing financial sanctions on taxpayers who pursue litigation which is either frivolous or groundless from its inception or attempt unduly to prolong their day of reckoning.

With these preliminary observations, let me turn to the several considerations which I have previously mentioned. They are interrelated in various degrees and my discussion of them will reflect this interrelationship.

B. Increasing caseload

I start with the unusually large volume of litigation pending before the Tax Court. In so doing, I recognize that this factor alone would not, in and of itself, justify not enacting otherwise meritorious legislation awarding attorneys' fees and costs to successful tax litigants. But, when the other elements of the picture are taken into account, the Court's caseload becomes a significant consideration.

Over the past decade the docket of the Tax Court has steadily increased. During the last three years the increase has been astronomical. Thus, at the end of the fiscal year 1970 there were 12,040 cases pending before the Court. By 1975, the number had increased to 16,448. Five years later, there were 34,865. As of July 31, 1981, there were 44,363, an increase of 275 percent over 1970.[1]

The Court is very concerned about this monumental increase in its docketed cases. We are making every effort to decide cases more promptly, and, in fact, the number of opinions and decisions has increased in recent years. In fiscal 1977, 1,088 cases were closed by opinion; by fiscal 1980, the number had increased to 1,397, and we estimate almost 2,100 in fiscal 1981. Yet it is becoming increasingly difficult, if not impossible, to dispose of a sufficient number of cases to close the gap between the number of cases filed and the number disposed of (see footnote 5, infra), much less to do so

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[1] The following table reflects the increase in pending cases on a yearly basis since the fiscal year 1970:

Fiscal Year	Pending Cases	Increase Over Prior Year
1970	12,040	886
1971	12,660	620
1972	13,388	728
1973	13,792	404
1974	13,727	(65)
1975	16,448	2,721
1976	18,396	1,948
1977	21,298	2,902
1978	23,140	1,842
1979	27,043	3,903
1980	34,865	7,822
1981 (through 7/31)	44,363	9,498

in a reasonable period of time. There is much truth to the saying that "justice delayed is justice denied." This has been recognized by the Congress, which has directed that "[a] report upon any proceeding instituted before the Tax Court and a decision thereon shall be made as quickly as practicable."[2]

We strongly believe that a law mandating the award of attorneys' fees and costs in tax litigation will significantly burden the Court by diverting judicial time and resources from the resolution of disputes involving substantive tax issues to those involving such fees and costs. The Commissioner of Internal Revenue, the respondent in all cases, may well oppose every, or nearly every, application for an award of attorneys' fees. Time will be consumed in hearing such disputes, in deciding whether fees should be awarded and, if so, in what amount, and in justifying such decisions in written reports as required by existing law.[3] Moreover, if the award of such fees and costs should cover settled cases (see pp. 8-10, infra), where historically the Court's involvement has been minimal, the diversion of judicial time and energy will be further accentuated. Thus, we think that, irrespective of whether an award of fees and costs is sought, all litigants before the Tax Court will be adversely affected.

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[2] Sec. 7459(a), I.R.C. 1954.

[3] Sec. 7459(b), I.R.C. 1954.

There would also be additional delay in those specific cases in which petitioners did seek awards of attorneys' fees and costs. The propriety and amount of such awards could only be judged after the Court rendered its decision. Hearings would in all likelihood be required. If such hearings were held in Washington, the parties (and their witnesses) would incur potentially significant additional expense. If such hearings were held in the city where the trial was conducted, the parties would have to wait for their case to be set on a calendar for that particular city. Thus, the time for disposition from the filing of a petition to the entry of decision would be significantly increased.

C. Settlement process

Another very important element for consideration is the impact of the potential award of attorneys' fees and costs on the settlement of cases pending before the Court. Our concern is that proposed legislation will discourage settlement. At this point, I think the Subcommittee will be interested to know that, based upon my conversations with several Federal circuit and district court Judges, their experience in other areas where legal fees are now legislatively authorized or mandated, e.g., civil rights, clearly indicates that the settlement process has been seriously impaired.

Historically, the capacity of the Tax Court to cope with the volume of cases brought before it has depended upon a very

high percentage of cases being resolved in this fashion.[4] The Court seriously doubts whether it could effectively handle its docket if the settlement rate declined, especially in view of the burgeoning number of new cases. In fact, we are already deeply concerned as to our ability adequately to cope with the growing gap between the number of cases filed and those being disposed of by both court disposition and settlement.[5]

Tax litigation certainly can be an expensive process -- both for the taxpayer and for the Internal Revenue Service, whose procedures are subject to fiscal and other constraints and are therefore not, as some people believe, unlimited. However, the cost of litigation does have a salutary effect. It encourages the parties seriously to consider and discuss the

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[4] The following table reflects the number and percentage of cases (including small tax cases) which were settled since the fiscal year 1977:

Fiscal Year	Total Cases Closed	Cases Settled	Percentage of Closed Cases Settled
1977	10,374	7,492	72
1978	12,062	8,801	73
1979	13,382	9,557	71
1980	14,470	10,723	74
1981 (through 7/31)	15,672	11,429	73

[5] The following table reveals this growing gap:

Fiscal year	Number of Petitions Filed	Number of Cases Disposed of by Settlement or Decision
1977	12,339	10,374
1978	13,740	12,026
1979	17,126	13,382
1980	22,009	14,470
1981 (through 7/31)	24,978	15,672

possibility of settlement. It is only logical that, with less economic pressure, taxpayers will be less inclined towards settlement. Similarly, it may be expected that the Service will be less inclined to settle issues favorable to the taxpayer for fear of appearing to have initially taken an "unreasonable" position. In either case, litigation will be encouraged.

D. Small tax cases

The potentially adverse impact of legislation providing for attorneys' fees and costs in small tax cases also cannot be lightly dismissed. The small tax case procedure was established in section 7463, I.R.C. 1954, by the Tax Reform Act of 1969 as a manifestation of the desire of Congress to provide a forum whereby taxpayers could have their cases disposed of informally, expeditiously, and without the necessity of legal representation. The only condition attached to the utilization of this procedure, which was optional with the taxpayer, was his loss of the right of appeal. The procedure has been eminently successful. Thanks to the diligence and tact of our special trial judges, some 35 percent of the cases filed with the Court are treated as small tax cases, with another 20 percent eligible for such treatment (something the Court would like to encourage). It is not hard to imagine that, with the potential for awards to taxpayers of attorneys' fees and costs, the likelihood of taxpayers electing the

small claims procedure will be substantially reduced. As a consequence, the caseload of the Court will become more difficult to handle, to say nothing of the fact that additional cases will be required to be heard by the courts of appeals, since by hypothesis the right of appeal will not have been waived.

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All in all, we view the prospect of legislation providing for attorneys' fees and costs with deep concern but, if the Congress decides to legislate in this area, I assure you that we will fully and willingly discharge any responsibilities which are placed upon us. However, we do have some suggestions as to the content of any such legislation, and it is to that aspect of the situation that I will now turn my attention.

II. Specific Suggestions for Legislation

A. Basic elements

Despite the existence of legislation authorizing attorneys' fees and costs in other areas, there has been practically no experience in the area of tax litigation. We think that, under all the circumstances and considering some of the difficulties already adverted to and subsequently discussed, three basic elements should be embodied in any legislation:

(1) The award of attorneys' fees and costs should not be mandatory but should be left to the discretion of the Court, as is now provided in the Equal Access to Justice Act.

(2) The period during which the legislation is to be operative should be limited. In short, there should be a sunset provision (such as is contained in the Equal Access to Justice Act).

(3) Because of the large number of cases pending before the Court, the legislation should be applicable only to cases begun (petitions filed) six months or more after its effective date. This will avoid the filing of amended pleadings in the large number of pending cases (see footnote 1, supra), with the huge administrative burden that would entail.

The foregoing basic provisions would afford the opportunity to determine whether the concerns which I have previously voiced have substance and to develop the experience necessary to evolve appropriate standards for determining when and how much fees and costs should be avoided.

B. Financial sanctions on certain taxpayers

As a concommitant of any legislation, we strongly urge the inclusion of countervailing provisions authorizing the imposition of fees, costs, and penalties in respect of certain unsuccessful taxpayers.

To balance the interests of the parties and provide a two-way street, we suggest that consideration should be given

to the propriety of authorizing an award of attorneys' fees and costs of litigation to the Government in appropriate cases in which it prevails. The prospect of such an award would have at least two salutary effects. It would encourage settlement, so essential to the ability of the Court to handle its caseload. It would also discourage taxpayers from filing frivolous and groundless petitions. The Tax Court is receiving an ever-increasing number of cases involving so-called tax protestors and others who do not raise bona fide, substantive tax issues for resolution but rather merely seek a forum in which to espouse their particular beliefs. Although the Court presently has summary procedures by which to deal with these cases, they nevertheless require a disproportionate amount of time and serve to divert the Court's attention from more deserving cases.[6]

Alternatively, or perhaps additionally, we suggest that consideration be given to amending section 6673, I.R.C. 1954. That section authorizes the Court to award damages to the United States in an amount not in excess of $500 in those instances in which the taxpayer has instituted proceedings

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6 The Commissioner of Internal Revenue recently told the American Bar Association Section of Taxation that the government is losing billions of dollars each year in an uphill battle against tax evaders, illegal tax protesters, abusive tax shelters, and deadbeats. See Report of the Comptroller General dated July 8, 1981, on the subject Illegal Tax Protesters Threaten Tax System, submitted to the Chairman, Subcommittee on Commerce, Consumer and Monetary Affairs, House Committee on Government Operations.

merely for delay.[7] Again, in an effort to discourage the increasing number of unjustifiable petitions, the Court thinks that the maximum amount of damages should be substantially increased and the ground for awarding damages should be broadened to include frivolous and groundless cases. To date the effectiveness of the present section has been lessened by the difficulty in establishing that a specific taxpayer instituted proceedings "merely for delay."

C. Specific suggestions of statutory standards for awards are provided

First, we suggest that it would be more appropriate, as a standard, to use the standard of "arbitrary and capricious" rather than of "unreasonableness." This would be in keeping with what we understand to be the objective of legislation providing for the payment of attorneys' fees and costs in tax litigation, namely, to confine awards to situations where the

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[7] The section reads as follows:

SEC. 6673. DAMAGES ASSESSABLE FOR INSTITUTING PROCEEDINGS BEFORE THE TAX COURT MERELY FOR DELAY.

Whenever it appears to the Tax Court that proceedings before it have been instituted by the taxpayers merely for delay, damages in an amount not in excess of $500 shall be awarded to the United States by the Tax Court in its decision. Damages so awarded shall be assessed at the same time as the deficiency and shall be paid upon notice and demand from the Secretary and shall be collected as a part of the tax.

Internal Revenue Service has abused the exercise of its power. Moreover, this is the standard which the courts have historically used when they have shifted to respondent the burden of proof which normally is on the taxpayer.[8] It is hard to see why a taxpayer should be entitled to fees and costs in a situation which a court would find not sufficiently egregious to shift the burden of proof from the taxpayer to the Government.

Second, whatever standard is used, it should be made clear, at least in the committee reports, that the determination should be made based upon all facts and circumstances revealed by the record in the case. It should depend upon the evidence finally presented.[9] We believe it important that the committee reports specify that the Court is not required to examine the record of the administrative hearings or base its decisions on the information available to respondent at the time the deficiency notice was issued. In this connection, we have considered whether there should be a requirement that the taxpayer has pursued all administrative remedies in order to be eligible for an award of attorneys' fees and costs of litigation. The absence of such a requirement would be likely to encourage taxpayers to bypass the administrative process and thereby increase the amount of litigation. However, the same consequences

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[8] See Helvering v. Taylor, 293 U.S. 507 (1935).

[9] This is the procedure envisaged by the Congress in determining whether a jeopardy assessment should be set aside or reduced under section 7429, I.R.C. 1954. See H. Rept. 94-658, 94th Cong., 1st Sess., 303 (1975); S. Rept. 94-938, 94th Cong., 2d Sess., 365 (1976).

would flow, although in a different context, if such a requirement were imposed. We would urge that any provision dealing with this problem be very carefully tailored so as to minimize any added burden of litigation. In any event, we think that the committee reports should make clear that, in situations where the taxpayer has withheld from the Service significant information until the actual trial, he should not be entitled to an award of fees and costs even if he wins the case.

Third, we think that attorneys' fees and costs should be limited to those incurred during the actual preparation of the case for trial, the trial itself, and possibly an appeal. In this context, the Congress will need to consider the desirability of specifying the factors or types of factors which ought to be taken into account. This is a difficult area. Factors considered by courts in the context of civil rights and other non-tax litigation[10] may not be completely

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[10] A "classic" list of factors appears in Johnson v. Georgia Highway Express, Inc., 488 F.2d 174 (5th Cir. 1974), a civil rights case. There the Court of Appeals articulated the following twelve guidelines: (1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorney; (10) the undesirability of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases.

appropriate when it comes to evaluating a fee application in the Tax Court. One factor that we think should be expressly recognized is whether the prevailing party's conduct unduly protracted the controversy.[11]

Another factor that needs to be thoroughly considered is the impact of the amount in controversy. The majority of cases docketed before the Court during the first ten months of the fiscal year 1981 involve deficiencies in dispute in amounts less than $5,000.[12] If the amount in controversy is to be considered, then an award of fees might not be sufficient to compensate counsel. On the other hand, if the amount in controversy is not to be a limiting factor, then awards in

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[11] Cf. 28 U.S.C. sec. 1927 regarding counsel's liability for excessive costs.

[12] The following table categorizes by amount in dispute the number and percentage of deficiency cases docketed from October 1980 through July 1981:

Category	Cases	Percentage	Cumulative Percentage
$ -0- - $ 1,000	4,947	22.5	22.5
$ 1,001 - $ 1,500	1,820	8.3	30.8
$ 1,501 - $ 2,500	2,320	10.6	41.4
$ 2,501 - $ 5,000	2,523	11.5	52.9
$ 5,001 - $ 7,500	1,283	5.8	58.7
$ 7,501 - $ 10,000	907	4.1	62.8
$ 10,001 - $ 20,000	2,498	11.4	74.2
$ 20,001 - $ 50,000	2,887	13.2	87.4
$ 50,001 - $ 100,000	1,293	5.9	93.3
$100,001 - $ 500,000	1,174	5.3	98.6
$500,001 - $1,000,000	158	.7	99.3
over $1,000,000	143	.7	100.0
no amount specified	2,992		
	24,945		

excess of that amount would be possible, and probably the rule in smaller cases. In considering this matter, the Congress should take into account the Court's special procedures applicable to "small tax cases" which are designed to permit taxpayers effectively to present their own cases without legal assistance. See pp. 10-11, supra.

The Congress will also need to consider whether, and by what measure, fees should be awarded to pro se taxpayers and taxpayers who are represented by "in-house" salaried counsel.

In a related vein, consideration should be given to the range of items that the Subcomittee considers to be "court costs." Existing law treats "costs" somewhat narrowly.[13]

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[13] 28 U.S.C. sec. 1920 provides as follows:

Sec. 1920. Taxation of costs.

A judge or clerk of any court of the United States may tax as costs the following:

(1) Fees of the clerk and marshal;

(2) Fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case;

(3) Fees and disbursements for printing and witnesses;

(4) Fees for exemplification and copies of papers necessarily obtained for use in the case;

(5) Docket fees under section 1923 of this title;

(6) Compensation of court appointed experts, compensation of interpreters, and salaries, fees, expenses, and costs of special interpretation services under section 1828 of this title.

A bill of costs shall be filed in the case and, upon allowance, included in the judgment or decree.

"Costs" could arguably include expenses incurred for expert witnesses, accounting services, engineering reports, and any other item material to the litigation.

Finally, on the subject of the award, it may be that a maximum limit should be specified, for example, a fixed sum but, in any event, not in excess of twice the amount of the deficiency.

Fifth, it will be necessary to evaluate whether any award or denial of attorneys' fees and costs should be reviewable by the appropriate court of appeals and, if so, what standard should apply. It may well be appropriate to specify that any award or denial not be reviewable on appeal, as the Congress has done with respect of review of jeopardy assessments by the district courts.[14] In this connection, we note that, in small tax cases, the decision as to the amount of tax owed is not appealable (section 7463(b), I.R.C. 1954) and presumably this would apply to any award of fees and costs if such an award is to be made in respect of such cases. If appellate review is to be provided to any extent, we would suggest that the standard for review be that of a clear abuse of discretion.

I have left to the last what may prove to be the most troublesome issue which the Congress has to face, and that is how to determine initial eligibility for an award of

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[14] Sec. 7429(f), I.R.C. 1954.

attorneys' fees and costs. As I have previously pointed out, cases before the Tax Court often involve multiple issues. The taxpayer may win some issues and lose others. Indeed, most of the cases, whether disposed of by decision or settlement, fall into this category. If eligibility is defined in terms of the "prevailing party," how is that definition to be applied in such cases? Even confining the definition to the "significant issue" will not necessarily solve the problem. A $5,000 issue which the taxpayer wins may not be as significant as a $500 issue which he loses because the latter issue may dispose of a recurring problem in later years and, in that context, will clearly be the "significant issue." The possible permutations and combinations are endless.

III. Conclusion

The Tax Court handles over 90 percent of all tax cases brought before it, the district courts, and the Court of Claims. We are deeply concerned that legislation awarding attorneys' fees and costs of litigation in cases before the Court not unduly add to, and complicate, the already burdensome position in which the Court now finds itself and which is likely to prevail in the foreseeable future.

We think the following statement from the New York State Bar Association (see Hearings before the Senate Subcommittee on Oversight of the Internal Revenue Service of the Senate

Committee on Finance, on S. 1444, Taxpayer Protection and Reimbursement Act, July 19, 1979) is worthy of the Congress' most careful attention:

> . . . [I]t must be recognized that in legal disputes right and wrong are often matters of degree, or of fact; that a system that encourages the settlement of cases may be as desirable as one that pushes cases to trial; that the allowance of attorneys' fees may induce either more litigation or more prolonged litigation; and that any increased expenses of the Government will ultimately be borne by all taxpayers.

If Congress concludes that legislation is nevertheless deemed desirable, we again urge that it not make the award of fees and costs mandatory, but authorize such awards to be made in the discretion of the Court, that such standards as may be provided in the legislation be accompanied by appropriate specific guidance in the Committee reports, and that the legislation be applied only prospectively and be operative only for a limited period of time, so as to give the Congress an opportunity to reexamine the situation in light of experience.

In view of the scope of my comments, I believe it is unnecessary for me to evaluate separately each of the three bills presently under consideration.

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